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In The

Supreme Court of the United States

October Term, 1997

ALLAN R. POWELL, JOAN K. POWELL, RICHARD J. MONTGOMERY AND ADELE S. MONTGOMERY,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

PETITION FOR WRIT OF CERTIORARI

EDWARD L. BLANTON, JR.
Counsel of Record
404 Allegheny Avenue
Baltimore, Maryland 21204-4255
(410) 296-8160

Counsel for Petitioners

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

110 pp

QUESTIONS PRESENTED FOR REVIEW

As to Montgomery –

Did Congress intend to impose penalties designed to curb abuse of qualified employer plans upon participants in State retirement plans in which the abuses Congress sought to curtail do not – and cannot – exist?

As to Powell –

What is meant by the phrase 'balance to the credit' in the Internal Revenue Code when applied to the withdrawal of interest earned on excess and non-deductible employee contributions to a State-maintained retirement plan, which withdrawal is authorized by a legislative overhaul of the State's retirement programs?

As to both –

Is the withdrawal of interest earned on excess and non-deductible employee contributions to a State-maintained retirement plan a "retirement distribution" as that phrase is generally understood in the context of the Internal Revenue Code?

May a District Court judge properly sit by designation, as a member of an appellate panel, to decide what is, in effect, an appeal from his own opinion and ruling in the District Court?

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PETITION FOR WRIT OF CERTIORARI

Petitioners pray that a writ of certiorari be issued to review the decision of the United States Court of Appeals for the Fourth Circuit entered in these consolidated cases (a) to decide an important issue of federal law that has not been, but should be, decided by the Supreme Court of the United States and (b) to exercise this Court's supervisory power with respect to the designation of a district judge to sit on, and to write the opinion for, an appellate panel effectively affirming the district judge's decision in a related case with identical facts and legal issues, which related case was also appealed, but settled prior to argument.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit that gives rise to this Petition was entered on October 16, 1997 and is reported at 129 F.3d 321 (4th Cir. 1997). It is printed at A1 - A14. The opinions of the Tax Court of the United States in these cases are reported at 71 TCM 3154 (Montgomery) and 71 TCM 3157 (Powell). The opinions are printed at A15 - A37. The related case, *Conway v. United States,* is reported at 908 F.Supp. 292, (D.Md, 1995) and is printed at A38. By order dated December 9, 1997, the Fourth Circuit Court of Appeals denied a Petition for Rehearing and Suggestion for Rehearing *En Banc.* A55

JURISDICTION

The jurisdiction of this Court is invoked pursuant to 28 USC §1254(1). The jurisdiction of the United States Court of Appeals for the Fourth Circuit was invoked pursuant to 28 USC §7482. The jurisdiction of the Tax Court of the United States was invoked pursuant to 26 USC §7442 and §6213.

STATUTORY PROVISIONS AND RULES

26 USC §72(t)
26 USC §401(a)
26 USC §402(e)
26 USC §4980A
26 USC §4974(c)

STATEMENT OF THE CASE

In order to put its fiscal house in order, the State of Maryland in 1979, and again in 1984, amended its laws governing the state retirement system, replacing a plan to which employees made non-deductible contributions from previously taxed income with essentially a non-contributory plan integrated with Social Security. To encourage State employees to transfer to the new plan, the State offered to refund ***all*** contributions made by the employees to the old plan, with interest compounded at a rate as high as 15.5%.

The employees were advised by the State that the interest portion of their withdrawal could be rolled-over, taxfree, to an individual retirement account within sixty days of receipt. Enactment of the Tax Reform Act of 1986 called into question the accuracy of the state's tax advice.

In 1989, the State requested a ruling from the Internal Revenue Service, which was received in July 1990. The ruling threatened confiscation of the retirement funds of Petitioners, and thousands of other State employees, who acted on the State's advice, and faced the prospect of paying taxes, penalties, and interest equal to 125% of their retirement funds.

These cases are two of four appended by stipulation in the Tax Court of the United States. A dozen other tax refund suits now pending in the United States District Court for the District of Maryland also challenge the Internal Revenue Service ruling. Petitioners contend that the refund they received was not a "retirement distribution" as that term is precisely defined in the Internal Revenue Code, rulings, and regulations. For that reason, they should not be subject to penalties and additions to tax Congress intended to impose ***only*** upon taxpayers who seek unauthorized tax advantages from qualified plans. Such plans are referred to herein as "tax favored" plans, i.e. those to which employers make deductible contributions and receipt of income to employees is postponed until distribution after retirement.

Petitioners also contend that the phrase "balance to the credit" is vague and uncertain. Yet, it appears in otherwise precise definitions Congress has written defining "partial" distributions, "lump sum" distributions, and "qualified total" distributions in the Internal Revenue Code. The meaning of this phrase determines Petitioners' right to compute the tax on their withdrawal using ten-year forward averaging. Although Congress has now changed the law, effective June 1, 1993, to allow tax-free rollovers which Petitioners were denied, the

issues raised by this Petition will continue to vex taxpayers unless this Court grants Certiorari.

The lower Courts have held that the withdrawals received by the Petitioners were retirement distributions. As such, the withdrawals are subject to penalties and additions to tax Congress imposed upon premature and excess retirement distributions from "tax-favored" plans. The lower Courts also held that the Petitioners did not receive the "balance to [their] credit" in the Maryland Retirement System, and since they did not, they are not entitled to forward average their income tax, as Congress provided they could in the Tax Reform Act of 1986, if they in fact received the "balance to the credit" in the Retirement System.[1]

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[1] The Court is asked to note that the phrase "balance to the credit" is so vague and uncertain that it cannot be embraced in a meaningful sentence without implying a meaning which is by no means certain from the manner in which the phrase appears in the statute, or without assuming the phrase refers to something tangible or specified, such as an "account" assigned to the employee.

REASONS FOR GRANTING THE WRIT

I. AN IMPORTANT QUESTION OF FEDERAL INCOME TAX LAW GOVERNING APPLICATION OF PENALTIES AND ADDITIONS TO TAX TO WITHDRAWALS FROM A GOVERNMENTAL PLAN AUTHORIZED BY THE STATE LEGISLATURE HAS NOT BEEN, BUT SHOULD BE, DECIDED BY THIS COURT.

The intricately interwoven and lengthy provisions of 26 USC §401(a) set up qualification standards and abuse-prevention measures regulating "tax-favored" employer plans. Most, if not all, are not applicable to governmental plans, which are exempt from the standards applicable to "tax-favored" plans. For example, in 26 USC §412(h), Congress provides that the minimum funding standards do not apply to governmental plans. In 26 USC §401(a)(7), Congress provides that a "trust shall not constitute a qualified trust under this Section unless the plan of which it is a part satisfies the requirements of §411 (relating to minimum vesting standards), but §411(e)(1)(a) states that the minimum vesting standards "shall not apply to a governmental plan." If 26 USC §401(a) is read from beginning to end, it becomes quite clear that the plans there described are "tax favored" qualified plans, *not* governmental plans. There are but three (3) references therein to "governmental" plans, all of which exclude governmental plans from specific restrictions imposed upon "qualified employer" plans.

Petitioners' thesis is that penalties and additions to tax which were designed to prevent abuse of tax benefits available from qualified employer plans, should not be extended to distributions from plans which are not "tax-

favored." This principal is recognized by the United States Tax Court in *Larotonda v. Commissioner*, 89 TC 287 (1987), which concluded, from review of House and Senate Committee reports, that the premature distribution penalty imposed by 26 USC §72(t) was designed to prevent deductible contributions being made in high income years and withdrawn in low income years. As the Tax Court said, the penalty was clearly aimed at "tax-motivated withdrawals prior to retirement age." Since the Petitioners' contributions in these cases were not deductible, a penalty designed to discourage tax abuse should not be applied when no abuse is present or even possible.

Congress has legislated that the 26 USC §72(t) and §4980A penalties and additions to tax apply only to "retirement distributions." The Petitioners did not receive a retirement distribution from the Maryland Retirement System. Rather, excess contributions no longer necessary to fund benefits in the new pension plan were refunded, with interest. The parties stipulated that the Retirement System "purported to be, and at all times relevant to the Petition held itself out to be a 'qualified defined benefit plan' within the meaning of 26 USC §401(a)." They did not stipulate that it was a plan "described" in 26 USC §401(a).

The language Congress employed to impose the penalties and additions to tax involved in these cases limits them to retirement distributions from tax-favored plans. Congress did this by providing that the penalties apply ***only*** to "retirement distributions" from "qualified employer plans which are *described* in §401(a)." 26 USC §4980A(e)(1) defines a "retirement distribution" as "the amount distributed during the taxable year under (A) any

qualified employer plan. . . . " In §4980A(e)(2), a " 'qualified employer plan' means (A) any plan *described* in §401(a). . . . " (Emphasis supplied) The plans described in §401(a) are tax-favored plans, not governmental plans. If this plain statutory language is applied to Petitioners' withdrawals, there is no basis for the penalties and additions to tax under 26 USC §72(t) and 26 USC §4980A. The careful definition in the statute of a "retirement distribution" proves that Congress did not paint with a brush as broad as that employed by the lower courts in their decisions. Congress did not impose the penalty on distributions from *all* qualified employer plans; just on those qualified employer plans *described* in 26 USC §401(a).

II. THE DECISION OF THE CIRCUIT COURT IS NOT CONSISTENT WITH ITS VIEWS EXPRESSED IN *ADLER v. COMMISSIONER* AND *BROWN v. COMMISSIONER*.

On substantially identical facts, *Adler v. Commissioner*, 86 F.3d 378 (4th Cir. 1996) and *Brown v. Commissioner*, T.C. Memo. 1995-93, ***reversed***, 97 F.3d 1446 (4th Cir. 1997) (unpublished), found that the taxpayers received "partial distributions" (i.e., at least 50% of the "balance to the credit" in the Maryland Retirement System) and were nevertheless eligible for a tax-free rollover.[2] A "partial distribution" is defined as "***all*** or ***any*** part of the balance to the credit" of an employee in a qualified plan. A "lump

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[2] The Department of Justice contends, in the cases pending in the United States District Court for the District of Maryland, that *Adler* (and presumably *Brown*, as well) was "wrongly decided."

sum" distribution is defined as the "balance to the credit" of an employee in a qualified plan. Thus, a "lump sum" distribution (i.e., all of the balance to the credit) and a partial distribution (i.e., all or any part of the balance to the credit) are, by definition, one and the same. By calling "all" of "the balance to the credit" a "partial distribution," Congress' understanding of the phrase "balance to the credit" differs radically from that of the lower Courts.

The taxpayers in *Conway v. United States*, ***supra***, argued that the distributions they received were qualified total distributions made to them as a result of a partial termination of the Maryland Retirement System. 26 USC 402(a)(5)(E)(i)(I) defines a "qualified total distribution" as, *inter alia*, "1 or more distributions (I) within one taxable year of the employee on account of a termination of the plan of which the trust is a part . . . " A termination can be either total or partial for purposes of this section. The *Conway* case was decided by the Honorable Marvin J. Garbis, a respected tax lawyer prior to his appointment to the Bench. There were eight other cases linked to it by stipulation. Although the decision was appealed to the Fourth Circuit, the cases were settled prior to argument. Judge Garbis was specially assigned to hear Petitioners' cases in the Fourth Circuit Court of appeals, and he wrote the opinion for the panel which heard the case. Since the issues are the same, Petitioners believe they were denied the full and fair appellate hearing that Judge Garbis urged the taxpayers in *Conway* to seek. (A39)

In deciding the *Conway* case adversely to the taxpayer, the District Court held that regulations governing partial termination of qualified plans were not applicable to governmental plans (A49-51), but, in these cases, the "aggregation

of plans" provision of 26 USC §402(e)(4)(D)(ii), which on its face applies only to qualified employer plans, was (A12). Similarly, the temporary regulations, in which the Commissioner acknowledges a difference between a "tax-favored" employer plan and a governmental plan, did not prevent a governmental plan from escaping penalties Congress clearly intended to impose only on distributions from plans in which the employer files a tax return (A10-11).

There appears to be a "heads, I win; tails, you lose" mentality pervading governmental plan taxation in the Fourth Circuit. Regulations providing tax relief to distributions from qualified plans are held not applicable. Other regulations, which manifest an intent that only "tax-favored" plans are subject to penalties, are construed to impose the penalties on withdrawals from governmental plans. Yet, every provision of the law and regulations, which the lower courts put forward as an obstacle to beneficial tax treatment for Petitioners, is a provision placed in the law by Congress to curb abuses that are possible *only* in "tax-favored" employer plans.

The undisputed evidence in these cases was that a Maryland employee cannot, under State law, belong to both plans. It must be one plan or the other. Yet, a statute aimed at preventing abuse in the event of dual membership is extended to governmental plans where no such abuse has ever occurred, or ever could occur, in order to prohibit tax-free rollover and/or income averaging. This Court has often admonished that "tax laws . . . may not be extended beyond their clear import." *Miller v. Standard Nut Margarine Co.*, 284 U.S. 498, 508; 76 L.Ed. 422, 429; 52 S.Ct. 260 (1932). Doubts are to be resolved against the government, and in favor of the taxpayer. *United States v.*

Merriam, 263 U.S. 179, 188, 68 L.Ed. 240, 244, 44 S.Ct. 69 (1923). Here, the lower Courts resolved all doubts in favor of the government, and extended the language of the statute beyond its purpose.

The lower Court would not allow Petitioner Powell to forward average his income because he did not receive a "lump sum distribution." He did not receive a lump sum distribution, because he did not receive the "balance to the credit" from the retirement system. The undisputed evidence in these cases is that no accounts were maintained for participants in the retirement system, and none of Petitioner's contributions was transferred from the old plan to the new plan.

Prior to the decision in this case, no appellate court, of which Petitioners are aware, had dealt with the question of what the phrase "balance to the credit" means. The Fourth Circuit, in *Adler v. Commissioner*, ***supra***, held that a taxpayer in a substantially identical factual situation received at least 50% of the "balance to the credit" in the Maryland Retirement System. Petitioners contend that the phrase was never intended, by Congress, to apply to anything other than the monetary value of a participant's account. Moreover, the retirement system and the pension system are both defined benefit plans. The most fundamental thing about a defined benefit plan is that there are ***no*** accounts maintained for the participants. What, then, can a statute referring to the "balance to the credit" mean when applied to a plan which has ***no*** accounts for the participants?

Benefits in the State pension system are not vested and depend upon survivorship. Thus, when the taxpayer

withdrew his excess contributions and the interest earned thereon, he received *everything* to which he was entitled from the retirement system, and would never receive anything more from the pension system if he died before he retired. That was his "balance to the credit" as the term "balance" is commonly understood.

The District Court in *Conway* and the Court of Appeals in *Powell* decided that the years of service an employee had rendered, which determined the amount of pension to be received, was part of the "balance to the credit." Since the benefits to be paid from both plans depended upon the years of service, the lower Courts decided that use of common service credits to compute benefits in both plans, for which no monetary value was or could be assigned, proved that Petitioners did not receive the "balance to the credit" in the Retirement System.

The word "balance" is an accounting concept, in the context in which it is used in the Internal Revenue Code. As far back as 1828, Noah Webster, in defining the word "balance" as it relates to "accounts," recognized that "balance is the difference of two sums." *Webster's An American Dictionary of the English Language*, 1828. The 1964 edition of *Webster's New Twentieth-Century Dictionary of the English Language, Unabridged*, 2ED., continues to recognize this usage, referring to the "equality of debits and credits in an account," or "the excess of credits over debits or of debits over credits," or "the amount still owed after partial settlement."

In mathematical usage, the "balance" is that which is left after something else is taken away. Petitioner Powell

received his "balance" in the retirement system when he received his refund. The timing of the payments made to the Petitioner established this as a fact. The parties stipulated that he elected to transfer to the pension system on May 1, 1990, that his membership in the retirement system ended on May 31, 1990, and everything left to his credit in the retirement system was paid to him on June 29, 1990. Since Petitioner received the "balance to [his] credit" within the meaning of 26 USC §402(e)(4)(A), this Court is asked to hold that the transfer refund was a lump sum payment and Petitioner Powell was entitled to forward average his income.

CONCLUSION

WHEREFORE, Petitioners respectfully pray that this Court will issue a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

Respectfully submitted,

EDWARD L. BLANTON, JR.
Counsel of Record
404 Allegheny Avenue
Baltimore, Maryland 21204-4255
(410) 296-8160

Counsel for Petitioners

PUBLISHED

UNITED STATES COURT OF APPEALS

FOR THE FOURTH CIRCUIT

ALLAN R. POWELL; JOAN K. POWELL, *Petitioners-Appellants,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 96-2549

RICHARD J. MONTGOMERY; ADELE S. MONTGOMERY, *Petitioners-Appellants,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 96-2554

Appeals from the United States Tax Court.
(Tax Ct. Nos. 93-3499, 96-8028)

Argued: June 6, 1997

Decided: October 16, 1997

Before HAMILTON and LUTTIG, Circuit Judges, and GARBIS, United States District Judge for the District of Maryland, sitting by designation.

Affirmed by published opinion. Judge Garbis wrote the opinion, in which Judge Hamilton and Judge Luttig joined.

COUNSEL

ARGUED: Edward L. Blanton, Jr., Baltimore, Maryland, for Appellants. Kenneth W. Rosenberg, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellee. **ON BRIEF:** Loretta C. Argrett, Assistant Attorney General, Richard Farber, Tax Division, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellee.

OPINION

GARBIS, District Judge:

Appellants Allan R. and Joan K. Powell and Appellants Richard J. and Adele S. Montgomery appeal from decisions of the United States Tax Court holding them liable for assessed taxes on excess distributions from their respective retirement plans.

I. *INTRODUCTION*

A. *In General*

Succinctly put, the Internal Revenue Code permits employers to place part of the compensation paid to an employee into a qualified, tax-sheltered retirement account. The employer obtains a deduction for the contribution at the time it is made. However, the employee does not treat the amount of compensation placed into the plan as current income, and does not report the

income earned in the plan prior to distribution. Only at the time the employee receives a distribution from the plan does he/she recognize income with regard to the distribution.

There are various restrictions upon the timing and amounts of distributions from a qualified pension plan. "Early" distributions[1] are subject to additional tax burdens, as are distributions in excess of permissible amounts.

The instant cases arise because the taxpayers chose to switch from one retirement plan to another and, in connection with their switches, received distributions of the funds in their accounts. These distributions were subject to income tax and resulted in Internal Revenue Service ("IRS") determinations of liability for the additional tax burdens at issue in these cases.

B. *Statutory Framework*

A "retirement distribution" is an amount distributed under an individual retirement plan or under a qualified employer plan. *See* § 4980A(e)(1).[2] A qualified employer plan is a "plan described in section 401(a) which includes a trust exempt from tax under section 501(a)," § 4980A(e)(2)(A), that the Commissioner has at any time determined to be a qualified pension plan pursuant to section 401. *See* § 4980A(e)(2).

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[1] That is, distributions made before the employee reaches a specified age or certain other events occur.

[2] All statutory references herein are to the Internal Revenue Code of 1986, 26 U.S.C., unless otherwise indicated.

Section 4980A imposes a fifteen percent excise tax on "excess distributions" from qualified retirement plans. An "excess distribution" is the amount of a retirement distribution which exceeds an exempt threshold. *See* § 4980A(c)(1). The exemption is normally $150,000. *See* § 4980A(c)(1)(A). However, if a distribution qualifies as a "lump sum distribution," the exempt threshold is increased five fold, to $750,000. *See* § 4980(c)(4).

Section 72(t) imposes a ten percent tax on the gross income included in "early" distributions from qualified retirement plans.[3] A distribution is "early" if made before the employee reaches age 59½. *See* § 72(t)(2)(A)(I).[4]

II. *BACKGROUND*

In 1927, the State of Maryland created a fund to provide retirement benefits for teachers employed by the state. Maryland created a similar fund in 1941 to provide retirement benefits for all state employees. The two systems, collectively, are referred to as "the Old Retirement System." The Old Retirement System required a non-deductible five percent contribution from all participants. The Old Retirement System was a "qualified defined benefit plan" within the meaning of 26 U.S.C. § 401(a).

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[3] The term "qualified retirement plan" in § 72(t)(1) includes, as it does for purposes of § 4980A, "a plan described in Section 401(a) which includes a trust exempt from tax under section 501(a)." This definition includes "any plan . . . which, at any time, has been determined by the Secretary [of the Treasury] to be such a plan." § 4974(c).

[4] The § 72(t) tax is subject to various exceptions, none of which are relevant to the instant cases. *See* § 72(t)(2).

Therefore, the trusts maintained by the Old Retirement System were tax-exempt trusts under 26 U.S.C. § 501(a).

In the late 1970's, actuarial projections indicated that the Old Retirement System was dangerously underfunded. In response to those findings, the State closed eligibility for participation in the Old Retirement System as of January 1, 1980. The State also developed the Maryland Employees' Pension System ("the Employees' Pension System") and the Maryland Teachers' Pension System (the "Teachers' Pension System") to provide retirement benefits for state employees and teachers hired after January 1, 1980. The Teachers' Pension System required nondeductible contributions only from those participants who had salaries greater than the taxable wage base set for Social Security benefits. The Teachers' Pension System was a "qualified defined benefit plan" within the meaning of 26 U.S.C. § 401(a), and the trusts maintained by the Teachers' Pension System were, therefore, tax-exempt trusts under § 501(a).

In 1989, the State passed further pension reform legislation. At that point, participants in the Teachers' Pension System had the following four options:

a. Pay an additional two percent of salary and retain unlimited cost of living adjustments on their benefits at the time of retirement;

b. Freeze their rate of contribution at the then-current level and retain the same benefit formula with the understanding that any future cost of living adjustment would be limited to a maximum of a five percent increase in any one year;

c. Participate in a hybrid plan whereby they would receive benefits based on the Teachers' Pension System formula to the extent of retirement credit earned up to July 1, 1984, and benefits based on the new pension system formula for credit earned after that date; or

d. Transfer into a new system ("the New Pension System").

See Conway v. United States, 908 F. Supp. 292, 294 (D. Md. 1995); *Md. State Teachers' Ass'n v. Hughes*, 594 F. Supp. 1353 (D. Md. 1984) (providing a detailed description of Maryland pension reform).

Appellants Allan R. Powell ("Powell") and Richard J. Montgomery ("Montgomery") were participants in the Teachers' Pension System who chose to transfer into the New Pension System.

III. *THE CASES ON APPEAL*

In 1990, Appellants Powell and Montgomery transferred from the Teachers' Pension System to the New Pension System. At the time of the transfer, each received a distribution ("Transfer Refund") of their paid-in mandatory deductible contribution to the Retirement System, plus the interest earned on such paid-in contributions. The Transfer Refunds were:

	Powell	*Montgomery*
Previously Taxed Contributions	$ 20,477.11	$ 37,064.27
Interest[5]	456,611.19	301,386.74[6]
	$477,088.30	$338,451.01

Powell and Montgomery filed 1990 joint federal income tax returns with their respective wives reporting thereon the taxable portion of their Transfer Refunds. Moreover, Montgomery reported an additional tax of $30,139[7] due to the "early" distribution included in the Transfer Refund.

The Internal Revenue Service reviewed the Powell and Montgomery 1990 federal income tax returns and issued Notices of Deficiency[8] determining that additional taxes should be assessed with regard to each return.

The notice of deficiency issued to Mr. and Mrs. Powell determined that they would be assessed the § 4980A tax on an excess distribution from a qualified retirement

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[5] Interest was computed at the rate of 15.57% per annum.

[6] This amount includes $300,984.04 of interest plus $403.70 of "employer pickup contributions" (plus interest thereon).

[7] That is, ten percent of the net of the $338,048.31 Transfer Refund less the $37,064.27 of previously taxed contributions.

[8] A notice of deficiency is issued pursuant to § 6213 of the Internal Revenue Code. A taxpayer has a period, generally 90 days from the issuance of the notice of deficiency (§ 6213(a)), to petition the United States Tax Court and obtain preassessment judicial review of the Commissioner's determination. *See* PAULA M. JUNGHANS AND JOYCE K. BECKER, Federal Tax Litigation ¶ 3.04 (1992); MICHAEL SALTZMAN, IRS Practice and Procedure ¶ 10.02[a][ii] (2nd Ed. 1991).

plan, to wit, a distribution of $456,611. The tax was computed to be $45,992, being 15% of $306,611 (the net of $456,611 less an exemption of $150,000). The Powells filed a timely Tax Court petition denying liability for the § 4980A tax and claiming[9] that the distribution qualified as a "lump-sum distribution" under § 402(e)(4)(D). Lump sum treatment would effectively eliminate the § 4980A liability[10] and would entitle them to a refund of a portion of the income taxes which they had reported as due on their tax return.[11] The Tax Court sustained the Commissioner, determined that there was a deficiency, and denied the claim for refund of income tax.

The notice of deficiency issued to Mr. and Mrs. Montgomery indicated that they would be assessed the § 4980A excess distribution tax, which in their case amounted to $7,569.[12] Upon receipt of the deficiency notice, Mr. & Mrs. Montgomery filed a timely Tax Court petition denying liability for the § 4980A tax. They also claimed that they had erroneously reported liability for the § 72(t) tax and, therefore, sought a refund of their payment of $30,139 of such tax. The Tax Court sustained the Commissioner, decided that there was a deficiency of

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[9] In an amended petition.

[10] By virtue of the $750,000 exemption afforded "lump sum distributions" in § 4980A(c)(4).

[11] A "lump sum distribution" could qualify for preferential ten year forward averaging treatment which, in effect, reduces the income tax payable with regard to the distribution. *See* § 402(e)(1).

[12] This is 15% of the excess distribution of $301,387 (i.e. $22,708), less an offset of $15,139 by virtue of the concomitant liability for the § 72(t) tax.

$7,569 as had been determined in the notice of deficiency, and denied the claim for refund of the § 72(t) tax.

On appeal, the Appellants assert that the Transfer Refunds were not distributions from a qualified plan subject to the § 4980A excise tax and the § 72(t) tax. In addition, the Powell Appellants contend that even if the Transfer Refund were a distribution from a qualified plan, it was a lump sum distribution that created an increased exemption from the § 4980A tax and would be eligible for preferential forward averaging treatment for income tax purposes.

IV. *DISCUSSION*

A. *Were the Transfer Refunds Amounts Distributed Under A Qualified Employer Plan?*

Appellants state that a distribution from a qualified employer plan of an amount in excess of the actual earnings on employee contributions automatically disqualifies the plan. Consequently, they argue, the Transfer Refunds could not have been distributions from a "qualified" plan subject to the taxes imposed by §§ 72(t) and 4980A. This boils down to the contention that because the distributions in question would by their nature disqualify the plan when made, then logically the plan could not have been qualified at the time of distribution. Therefore, according to the Appellants, the Transfer Refunds were merely "withdrawal(s) of contributions and interest in excess of that actually earned." In making this argument, the Appellants seek to have the Court ignore the plain language of the statute.

For purposes of the excise taxes imposed by §§ 72(t) and 4980A, a retirement plan is deemed to be a "qualified plan," even if it is not qualified on the date of the distribution, so long as the Commissioner *at any time had determined* that the plan was qualified. *See* §§ 4974(c), 4980A(e)(2). In this case, the New Pension System had been determined to be a plan described in § 401(a) that included a trust exempt from tax under § 501(a) on June 23, 1982. Therefore, the Court must apply the statute as written and reject Appellants' "logical" argument.

As a second line of defense, Appellants, relying on certain temporary regulations issued by the Commissioner, argue that the term "qualified employer plan" does not include government plans because they are not required to file a federal income tax return.

Section 54.4981A-1T(a-3)(c)(2)(I), Temporary Qualified Pension Plan Excise Tax Regs., 52 Fed. Reg. 46750 (1987) provides that an employee plan that is maintained by an employer who "has at any time filed an income tax return and claimed deductions that would be allowable under section 404," is a "qualified" plan. However, the cited Temporary Regulations do not provide an exclusive definition of those plans that will be considered "qualified employer plans." Rather, the Temporary Regulations merely advise that even a plan which has not been the subject of an express IRS determination will be considered a "qualified employer plan" so long as the employer

itself has filed an income tax return and claimed deductions based upon the plan's asserted qualified status.[13] The fact that the New Pension System is a government plan, and thus not one as to which the employer has claimed an income tax deduction, does not change its status as a "qualified employer plan" under the statutory provisions here at issue.

For the foregoing reasons, we conclude that the Transfer Refunds were distributions from a "qualified employer plan" and, therefore, that the § 4980A tax is applicable to the Appellants. Moreover, as to Montgomery, who was less than 59½ years of age at the time of distribution, the § 72(t) tax is applicable.

B. *Was the Transfer Refund to Powell a Lump Sum Distribution?*

As discussed above, the § 4980A tax applies to the extent that a distribution exceeds a threshold exemption of $150,000. If the distribution is a "lump sum distribution" to which an election under § 402(e)(4)(B) applies, then the exemption is increased to $750,000. *See* § 4980A(c)(4).

Section 402(e)(4)(A) defines a "lump sum distribution" as a:

> distribution or payment within one taxable year of the recipient of *the balance to the credit* of an

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[13] This closes a potential loophole for an employer plan which was placed in operation without an advance ruling of qualification.

> employee which becomes payable to the recipient
>
> * * *
>
> (ii) after the employee attains age 59½,
>
> * * *
>
> from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501.

(emphasis added). In this case, if the Transfer Refund to Powell (who was at the time over 59½ years of age) constituted a payment of "the balance to the credit" of Powell, it would be a lump sum distribution under § 402(e)(4)(A).

Section 402(e)(4)(D)(ii) provides that "[f]or purposes of determining the balance to the credit of an employee . . . all pension plans maintained by the employer shall be treated as a single plan." The Teacher's Pension System and the New Pension System are maintained by the same employer, the State of Maryland. Therefore, the Teacher's Pension System and the New Pension System must be treated as a single plan. *See Dorsey v. Commissioner,* T.C. Memo 1995-97; *Brown v. Commissioner,* T.C. Memo 1995-93; *Hoppe v. Commissioner,* T.C. Memo 1994-635; *Hamilton v. Commissioner,* T.C. Memo 1994-633.

Under Maryland law, Powell's monthly annuity from the New Pension Plan is calculated by taking into account his "average final compensation" and his years of "creditable service," including the years under the Teachers' Pension Retirement System. Upon transfer to the New Pension System, Powell did not forfeit his right to receive future monthly annuities, but rather agreed to receive a

large single payment followed by reduced monthly annuities. Moreover, any transferee who had a contribution not eligible for refund would have the contribution transferred into the transferee's New Pension System account, "along with his or her service credits, salary level, and relevant past information accumulated by the Retirement Agency." *Conway v. United States*, 908 F. Supp. 292, 296 (D. Md. 1995); *see* Md. Code Ann. art. 73B, § 32. In addition, as stated in *Conway*, "although intangibles such as service credits and salary level may not have a definite or immediately discernible pecuniary worth, they nonetheless represent real value in the calculation of future New Pension System benefits." *Conway*, 908 F. Supp. at 296. Accordingly, when Powell transferred from the Teacher's Pension System to the New Pension System he received the balance to his credit in two parts, the Transfer Refund payment at issue and the right to receive a monthly annuity from the New Pension System upon retirement.

In the case at bar, Powell did not receive the final and *complete* payout of his benefits at the time of transfer because he remained entitled to receive monthly annuities. Therefore, the Transfer Refund received by Powell did not constitute the entire balance to the credit of his account. Accordingly, it is not a "lump sum distribution" within the meaning of § 4980A. For this reason, we affirm the Tax Court's determination that Appellant Powell is not entitled to an increased exemption of $750,000 from the § 4980A tax penalty under § 4980A(c)(4).

C. *Can Powell Obtain Preferential Ten Year Forward Averaging Treatment?*

Powell contends that he is entitled to preferential ten year forward averaging treatment pursuant to § 402(e)(1) so as effectively to reduce his income tax liability on the Transfer Refund.

Generally, the taxable portions of distributions from a qualified plan are subjected to income tax for the year of receipt.[14] However, if a distribution is a "lump sum distribution," then it is eligible for preferential ten year forward averaging treatment pursuant to § 402(e)(1).[15] However, as discussed above, the Transfer Refund was not a "lump sum distribution" within the meaning of 402(e)(4)(A). Therefore, Powell is not entitled to the preferential forward averaging treatment provided by § 402(e)(1).

For the foregoing reasons, the decisions of the Tax Court are, in all respects,

AFFIRMED.

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[14] Unless rolled over to another qualified plan or into an IRA.

[15] The Tax Reform Act of 1986 replaced ten year forward averaging with five year forward averaging of lump sum distributions made after December 31, 1986. However, individuals (such as Powell) who were fifty years old before January 1, 1986, are eligible for ten year forward averaging.

T.C. Memo. 1996-264

UNITED STATES TAX COURT

ALLAN R. POWELL AND JOAN K. POWELL, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 3499-93. Filed June 11, 1996.

Edward L. Blanton, Jr., for petitioners.

Alan R. Peregoy, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

DAWSON, *Judge*: This case was assigned to Special Trial Judge Robert N. Armen, Jr., pursuant to the provisions of section 7443A(b)(4) of the Internal Revenue Code of 1986, as amended, and Rules 180, 181, and 183.[1] The Court agrees with and adopts the Opinion of the Special Trial Judge, which is set forth below.

OPINION OF THE SPECIAL TRIAL JUDGE

ARMEN, *Special Trial Judge*: Respondent determined a deficiency in petitioners' Federal excise tax[2] under section 4980A for the taxable year 1990 in the amount of

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the taxable year in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2] In the notice of deficiency, respondent characterized the deficiency as a deficiency in income tax rather than excise tax. It would appear that respondent erred in this regard.

$45,991.[3] In an amended petition, petitioners claimed an overpayment of income tax by electing to use the 10-year forward averaging provisions under section 402(e)(1).

After a concession by respondent,[4] the primary issue for decision is whether petitioner Allan R. Powell is liable for the 15-percent excise tax under section 4980A for the taxable year 1990. The resolution of this issue turns on whether a Transfer Refund distribution was paid from a qualified employer plan pursuant to section 4980A(e)(2). If we decide that the Transfer Refund distribution was paid from a qualified employer plan under section 4980A(e)(2), then we must also decide whether such distribution qualifies for 10-year forward averaging under section 402(e)(1).

FINDINGS OF FACT

Some of the facts have been stipulated, and they are so found. Petitioners resided in Hagerstown, Maryland, at the time their petition was filed with the Court.

Petitioner Allan R. Powell (petitioner) was a teacher for 41 years in the Baltimore and Hagerstown Public Schools until his retirement, effective July 1, 1992. At the time of trial, petitioner was employed as a part-time

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[3] Sec. 4980A imposes a 15-percent excise tax on excess distributions from qualified retirement plans. This tax is included within ch. 43 of the I.R.C. and is subject to the deficiency procedures set forth in subch. B of ch. 63 of the I.R.C. See sec. 6211(a).

[4] Respondent concedes that petitioner Joan K. Powell is not liable for the deficiency in issue herein.

professor at Hagerstown Junior College. As an employee of the Baltimore and Hagerstown Public Schools, petitioner was a member of the Maryland State Teachers' Retirement System (the Retirement System) until he transferred to the Maryland State Teachers' Pension System (the Pension System) on June 1, 1990.

In determination letters dated June 23, 1982, respondent determined that the Retirement System and the Pension System were qualified plans under section 401(a) and that they maintained trusts that were exempt from income tax under the provisions of section 501(a). In 1984, 2 years after respondent issued the determination letters, the Maryland State legislature amended some of the provisions of the Retirement System. Respondent did not re-evaluate the provisions of the Retirement System after the enactment of the 1984 amendments by the Maryland State legislature.

The Retirement System requires mandatory nondeductible employee contributions. In contrast, the Pension System does not generally require such contributions. The State of Maryland contributes to both the Retirement System and the Pension System on behalf of the members of those systems.

On May 1, 1990, petitioner elected to transfer from the Retirement System to the Pension System, effective June 1, 1990. As a result of the election to transfer, petitioner received a distribution (the Transfer Refund) from the Retirement System in the amount of $477,088.30. Petitioner received the Transfer Refund in the form of a check dated June 29, 1990.

Petitioner's Transfer Refund consisted of $20,477.11 in previously taxed contributions made by petitioner during his employment tenure with Baltimore and Hagerstown Public Schools, and $456,611.19 of taxable earnings in the form of interest. The earnings; i.e. $456,611.19, constitute the taxable portion of the Transfer Refund.

When petitioner transferred from the Retirement System to the Pension System, and when he received his Transfer Refund, he had attained the age of 64. If petitioner had not transferred to the Pension System but rather had remained a member of the Retirement System, he would have been entitled to retire at an appropriate age and receive a normal service retirement benefit, including a regular monthly annuity. He would not, however, have been entitled to receive a Transfer Refund because a Transfer Refund is only payable to those who elect to transfer from the Retirement System to the Pension System.

As a result of transferring from the Retirement System to the Pension System, petitioner became, and presently is, a member of the Pension System. As a member of the Pension System, petitioner became entitled, upon retirement, to receive a retirement benefit based upon his salary and his creditable years of service, specifically including those years of creditable service recognized under the Retirement System. However, because petitioner received the Transfer Refund on account of transferring from the Retirement System to the Pension System, petitioner's monthly annuity is less than the monthly annuity that he would have received if he had not transferred to the Pension System but had ultimately retired under the Retirement System.

On March 17, 1992, petitioner applied for a normal service retirement from the Pension System, effective July 1, 1992. Petitioner is currently receiving a pension from the Pension System.

On their Federal income tax return (Form 1040) for 1990, petitioners reported "total pensions and annuities" in the amount of $477,088. Of this amount, petitioners reported $456,611 as the taxable amount.

In the notice of deficiency, respondent determined a deficiency in petitioners' excise tax under section 4980A in the amount of $45,991.[5] In an amended petition, petitioners claimed an overpayment of income tax by electing to use the 10-year forward averaging provisions under section 402(e)(1). Respondent contends that petitioners do not qualify for 10-year forward averaging because the Transfer Refund did not constitute a "lump sum distribution" within the meaning of section 402(e)(4)(A).

OPINION

The primary issue for decision is whether petitioner Allan R. Powell is liable for the 15-percent excise tax under section 4980A for 1990. As previously noted, the resolution of this issue turns on whether the Transfer Refund was paid from a qualified employer plan within the meaning of section 4980A(e)(2).

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[5] See *supra* note 4 regarding respondent's concession; see *supra* note 2 regarding respondent's mischaracterization of petitioners' excise tax deficiency.

Section 4980A imposes a 15-percent excise tax on excess distributions from qualified retirement plans. Sec. 4980A(a). As relevant herein, an "excess distribution" is defined as the aggregate amount of "retirement distributions" with respect to any individual during any calendar year to the extent that such amount exceeds $150,000. Sec. 4980A(c)(1). The definition of an excess distribution is modified, however, for a "lump sum distribution" to which a forward averaging election under section 402(e)(4)(B) applies. Thus, as relevant herein, if the aggregate retirement distributions with respect to any individual include a lump sum distribution to which an election under section 402(e)(4)(B) applies, an "excess distribution" exists to the extent that the retirement distributions exceed $750,000; i.e., five times the amount of the limitation otherwise provided by section 4980A(c)(1). Sec. 4980A(c)(4).

Retirement distributions are the amount distributed to an individual under an individual retirement plan or any "qualified employer plan" with respect to which such individual is or was the employee. Sec. 4980A(e)(1). As relevant herein, section 4980A(e)(2) defines a qualified employer plan as "a plan described in section 401(a) which includes a trust exempt from tax under section 501(a)" and a plan which, at any time, has been determined by the Commissioner to be such a plan.

Petitioners contend that the Retirement System does not satisfy the definition of a qualified employer plan for two primary reasons. First, petitioners argue that the term "qualified employer plan" as used in section 4980A(e)(2) and section 54.4981A-1T(a-3)(c)(2), Temporary Qualified Pension Plan Excise Tax Regs., 52 Fed. Reg.

56750 (Dec. 10, 1987), does not contemplate governmental plans such as the Retirement System. Second, petitioners argue that the amendments made to the Retirement System in 1984 violate various provisions of section 401(a) and terminated its qualified status so that the Retirement System was not a qualified employer plan at the time that it issued petitioner's Transfer Refund in 1990. Petitioners further argue that the excise tax under section 4980A should not apply to petitioner's Transfer Refund unless the Retirement System was a qualified employer plan at the time that it distributed the Transfer Refund.

We have previously considered and rejected petitioners' contention in *Montgomery v. Commissioner,* T.C. Memo. 1996-263. We see no need to revisit the issue. Therefore, for the reasons stated in *Montgomery v. Commissioner, supra,* we hold that petitioner received a retirement distribution under section 4980A(e)(1) in the amount of $456,611.

We now turn to petitioners' alternative argument. If the Retirement System is a qualified employer plan, petitioners contend the following: (1) The Transfer Refund was a lump sum distribution, (2) petitioner elected forward averaging under section 402(e), and (3) there was no excess distribution because petitioners's lump sum distribution and annuity payments did not exceed $750,000. The resolution of this issue turns on whether the Transfer Refund constitutes a lump sum distribution within the meaning of section 402(e)(4)(A).

A "lump sum distribution" is defined in section 402(e)(4)(A) as follows:

> (A) Lump sum distribution.--For purposes of this section * * * , the term "lump sum distribution" means the distribution or payment within one taxable year of the recipient of the *balance to the credit* of an employee which becomes payable to the recipient –
>
> (i) on account of the employee's death,
>
> (ii) after the employee attains age 59½,
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> (iii) on account of the employee's separation from the service, or
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> (iv) after the employee has become disabled * * * from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 * * * . For purposes of this subsection, the balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of section 72(o)(5)). [Emphasis added.]

There is no dispute that the Transfer Refund was received by petitioner after he attained the age of 59½, nor is there any dispute that the Transfer Refund was distributed within a single taxable year. Moreover, for purposes of deciding whether petitioner received a lump sum distribution, there is no dispute that the Retirement System is a plan described in section 401(a) and that the trust forming a part of the Retirement System is exempt from tax under section 501. Therefore, the only issue is whether petitioner received the "balance to the credit" when he received the Transfer Refund.

In determining a taxpayer's "balance to the credit", section 402(e)(4)(C) provides in relevant part:

> (C) Aggregation of certain trusts and plans. – For purposes of determining the balance to the credit of an employee under subparagraph (A) –
>
> > (i) all trusts which are part of a plan shall be treated as a single trust, *all pension plans maintained by the employer shall be treated as a single plan* * * * . [Emphasis added.]

This Court has previously held that section 402(e)(4)(C) requires that we treat the Retirement System and the Pension System as a single pension plan. *Dorsey v. Commissioner,* T.C. Memo. 1995-97; *Brown v. Commissioner,* T.C. Memo. 1995-93; *Hoppe v. Commissioner,* T.C. Memo. 1994-635; *Hamilton v. Commissioner,* T.C. Memo. 1994-633; see *Wheeler v. Commissioner,* T.C. Memo. 1993-561; see also *Sites v. United States,* 75 AFTR 2d 95-2503, 95-1 USTC par. 50,280 (D. Md. 1995). Thus, as a consequence of aggregating the Retirement System and the Pension System, we have held that a taxpayer's transfer from the Retirement System to the Pension System allows the taxpayer to receive the balance to his or her credit in two parts, an initial single payment (the Transfer Refund) and a reduced monthly annuity (based on all of the taxpayer's years of creditable service and on the taxpayer's salary during those years). Thus, we have consistently held that a Transfer Refund does not constitute a taxpayer's entire "balance to the credit" in the Retirement and Pension Systems and is therefore not a lump sum distribution within the meaning of section 402(e)(4)(A).

In view of the foregoing, we hold that the Transfer Refund did not constitute a lump sum distribution within the meaning of section 402(e)(4)(A) because petitioner did not receive the "balance to the credit" when he transferred from the Retirement System to the Pension System. Accordingly, petitioners are not entitled to the increased threshold amount, i.e., $750,000, set forth in section 4980A(c)(4) in determining the amount of petitioner's excess distributions for purposes of the excise tax under section 4980A.

Because petitioner received a retirement distribution under section 4980A(e)(1) in the amount of $456,611, we sustain respondent's determination that petitioner received an excess retirement distribution in the amount of $306,611 ($456,611 less $150,000) and petitioner is therefore liable for the 15-percent excise tax under section 4980A.

We have considered petitioners' remaining arguments regarding section 4980A and find them unpersuasive.

Finally, we reject petitioners' claim of an overpayment of income tax because the Transfer Refund does not qualify for 10-year forward averaging under section 402(e)(1). The law is clear that if a distribution is not a "lump sum distribution" within the meaning of section 402(e)(4)(A), then such distribution does not qualify for forward averaging under section 402(e)(1). E.g., *Clark v. Commissioner*, 101 T.C. 215, 218-219 (1993). We have already held, *supra* at p. 10, that the Transfer Refund did not constitute a lump sum distribution because petitioner

did not receive the "balance to the credit" when he transferred from the Retirement System to the Pension System. Consequently, the Transfer Refund does not qualify for forward averaging.

In order to give effect to our disposition of the disputed issues, as well as respondent's concession,

Decision will be entered under Rule 155.

T.C. Memo. 1996-263

UNITED STATES TAX COURT

RICHARD J. MONTGOMERY AND ADELE S. MONTGOMERY, Petitioners
v. COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 8028-94. Filed June 11, 1996.

Edward L. Blanton, Jr., for petitioners.

Alan R. Peregoy, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

DAWSON, *Judge*: This case was assigned to Special Trial Judge Robert N. Armen, Jr., pursuant to the provisions of section 7443A(b)(4) of the Internal Revenue Code of 1986, as amended, and Rules 180, 181, and 183.[1] The Court agrees with and adopts the Opinion of the Special Trial Judge, which is set forth below.

OPINION OF THE SPECIAL TRIAL JUDGE

ARMEN, *Special Trial Judge*: Respondent determined a deficiency in petitioners' Federal excise tax under section

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the taxable year in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

4980A for the taxable year 1990 in the amount of $7,569.[2] In the petition, petitioners claimed an overpayment of income tax in the amount of $30,139 with respect to the additional tax imposed under section 72(t).

After a concession by respondent,[3] the issues for decision are: (1) Whether petitioner Richard J. Montgomery is liable for the 15-percent excise tax under section 4980A for taxable year 1990; and (2) whether petitioners are liable for the 10-percent additional tax imposed under section 72(t) on early distributions from qualified retirement plans for the taxable year 1990. The resolution of these issues turns on whether a Transfer Refund distribution was paid from a qualified plan pursuant to sections 4980A(e)(2), 72(t), and 4974(c).

FINDINGS OF FACT

Some of the facts have been stipulated, and they are so found. Petitioners resided in Hagerstown, Maryland, at the time that their petition was filed with the Court.

Petitioner Richard J. Montgomery (petitioner) is a teacher. He was employed by the Hagerstown, Maryland Community College (the Hagerstown Junior College) in 1990 and remained so employed at least through the time

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[2] Sec. 4980A imposes a 15-percent excise tax on excess distributions from qualified retirement plans. This tax is included within ch. 43 of the I.R.C. and is subject to the deficiency procedures set forth in subch. B of ch. 63 of the I.R.C. See sec. 6211(a).

[3] Respondent concedes that petitioner Adele S. Montgomery is not liable for the deficiency in issue herein.

that this case was submitted for decision. As an employee of the Hagerstown Junior College, petitioner was a member of the Maryland State Teachers' Retirement System (the Retirement System) until he transferred to the Maryland State Teachers' Pension System (the Pension System) on June 1, 1990.

In determination letters dated June 23, 1982, respondent determined that the Retirement System and the Pension System were qualified plans under section 401(a) and that they maintained trusts that were exempt from income tax under the provisions of section 501(a). In 1984, 2 years after respondent issued the determination letters, the Maryland State legislature amended some of the provisions in the Retirement System. Respondent did not re-evaluate the provisions of the Retirement System after the enactment of the 1984 amendments by the Maryland State legislature.

The Retirement System requires mandatory nondeductible employee contributions. In contrast, the Pension System does not generally require such contributions. The State of Maryland contributes to both the Retirement System and the Pension System on behalf of the members of those systems.

On May 15, 1990, petitioner elected to transfer from the Retirement System to the Pension System, effective June 1, 1990. As a result of the election to transfer, petitioner received a distribution (the Transfer Refund) from the Retirement System in the amount of $338,451.01. Petitioner received the Transfer Refund in the form of two checks dated June 29, 1990, and November 30, 1990.

Petitioner's Transfer Refund consisted of $37,064.27, in previously taxed contributions made by petitioner during his employment tenure with Hagerstown Junior College, $402.70 in employer "pick-up contributions"[4] and interest thereon, and $300,984.04 of taxable earnings in the form of interest. The earnings, "pick-up contributions", and interest in the pick-up contributions; i.e. $301,386.74, constitute the taxable portion of the Transfer Refund.

When petitioner transferred from the Retirement System to the Pension System, and when he received his Transfer Refund, he had attained the age of 56. If petitioner had not transferred to the Pension System but had remained a member of the Retirement System, he would have been entitled to retire and receive a normal service retirement benefit, including a regular monthly annuity, at age 60. He would not have been entitled to receive a Transfer Refund because a Transfer Refund is payable only as a result of transferring from the Retirement System to the Pension System.

As a result of transferring from the Retirement System to the Pension System, petitioner became, and presently is, a member of the Pension System. As a member of the Pension System, petitioner is entitled to receive a retirement benefit based upon his salary and his creditable years of service, specifically including those years of

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[4] See sec. 414(h)(2). The parties stipulated that petitioner received $403.70 of employer pick up contributions and interest; however, the record demonstrates that petitioner actually received $402.70 of such contributions and interest.

creditable service recognized under the Retirement System. However, because petitioner received the Transfer Refund on account of transferring from the Retirement System to the Pension System, petitioner's monthly annuity is less than the monthly annuity that he would have received if he had not transferred to the Pension System but had retired under the Retirement System.

On their Federal income tax return (Form 1040) for 1990, petitioners reported "total pensions and annuities" in the amount of $338,451. Of this amount, petitioners reported $301,387 as the taxable amount. Petitioners attached Form 5329 (Return for Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts) to their return. In Part II of such form, petitioners reported liability for the additional tax under section 72(t) in the amount of $30,139.

In the notice of deficiency, respondent determined a deficiency in petitioners' excise tax under section 4980A in the amount of $7,569.[5] In the petition, petitioners claimed an overpayment of income tax in the amount of $30,139 with respect to the additional tax imposed under section 72(t).

OPINION

The issues for decision are whether petitioner Richard J. Montgomery is liable for the 15-percent excise tax under section 4980A, and whether petitioners are liable

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[5] See *supra* note 3 regarding respondent's concession.

for the 10-percent additional tax under section 72(t). As previously noted, the resolution of these issues turns on whether the Transfer Refund was paid from a qualified plan within the meaning of sections 4980A(e)(2), 72(t) and 4974(c).

1. Section 4980A Issue

Section 4980A imposes a 15-percent excise tax on excess distributions from qualified retirement plans. Sec. 4980A(a). As relevant herein, an "excess distribution" is defined as the aggregate amount of "retirement distributions" with respect to any individual during any calendar year to the extent that such amount exceeds $150,000. Sec. 4980A(c)(1). Retirement distributions are the amounts distributed to an individual under an individual retirement plan or any "qualified employer plan" with respect to which such individual is or was the employee. Sec. 4980A(e)(1). As relevant herein, section 4980A(e)(2) defines a qualified employer plan as "a plan described in section 401(a) which includes a trust exempt from tax under section 501(a)". A qualified employer plan includes any plan which, at any time, has been determined by the Commissioner to be such a plan.

Petitioners contend that the Retirement System has never met the definition of a qualified employer plan. In advancing this contention, petitioners rely on section 54.4981A-1T(a-3)(c)(2)(i), Temporary Qualified Pension Plan Excise Tax Regs., 52 Fed. Reg. 46750 (Dec. 10, 1987). This regulation provides, as relevant herein, that "an employer plan will be considered to have been treated as a qualified employer plan if any employer maintaining

the plan has at any time filed an income tax return and claimed deductions that would be allowable under section 404 (and that were not disallowed) only if the plan was a qualified employer plan under section 401(a) or 403(a)." Petitioners argue that this regulation is an exclusive definition of the term "qualified employer plan" and that such definition only includes those plans where the employer maintaining the plan is required to file a Federal income tax return. Thus, petitioners contend, the term "qualified employer plan" does not include governmental plans.

We disagree with petitioners. Sec. 54.4981A-1T(a-3)(c)(2)(i), Temporary Qualified Pension Plan Excise Tax Regs., does not offer an exclusive definition of qualified employer plans, rather, it illustrates one example of when a plan will be treated as a qualified employer plan. Under the plain language of section 4980A(e)(2), a qualified employer plan includes a plan which, at any time, has been determined by the Commissioner to be a qualified plan; i.e., by means of a determination letter, as in the present case. Thus, the fact the Retirement System is a governmental plan does not preclude it from satisfying the definition of a qualified employer plan.

Petitioners also contend that the amendments made to the Retirement System in 1984 violate various provisions of section 401(a) and terminated its qualified status so that the Retirement System was not a qualified employer plan at the time it issued petitioner's Transfer Refund in 1990. Petitioners argue that the excise tax under section 4980A should not apply to petitioner's Transfer Refund unless the Retirement System was a

qualified employer plan at the time that it distributed the Transfer Refund.

Respondent contends that, for purposes of section 4980A(a), the qualified status of the Retirement System at the time of petitioner's distribution is irrelevant. Specifically, respondent contends that, under the plain language of section 4980A(e)(2), once the Commissioner determines that a plan is a qualified employer plan, the plan's status for purposes of section 4980A is not changed by subsequent events that might disqualify the plan. Thus, respondent contends that the Retirement System is a qualified employer plan because respondent issued a determination letter to that effect on June 23, 1982. We agree with respondent.

Section 4980A(e)(2) defines a qualified employer plan to include any plan which, *at any time*, has been determined by the Commissioner to be such a plan. The regulations promulgated under section 4980A further provide: "Distributions under any plan * * * that has *at any time* been treated as a qualified employer plan * * * will be treated for purposes of section * * * [4980A] as distributions from a qualified employer plan * * * whether or not such plan * * * satisfies the applicable requirements at the time of the distribution." Sec. 54.4981A-1T(a-3)(c)(2), Temporary Qualified Pension Plan Excise Tax Regs. [Emphasis added.]

Petitioners' contention that the Retirement System is required to have been a qualified plan on the date of petitioner's distribution is inconsistent with the plain meaning of the words used in section 4980A(e)(2). That section merely requires that a plan be determined to be a

qualified employer plan at some point in time and not necessarily on the date of the retirement distribution.[6] In the instant case, respondent issued a determination letter on June 23, 1982, providing that the Retirement System was a plan described in section 401(a) that included a trust exempt from tax under section 501(a). Thus, under the plain language of section 4980A(e)(2), and under section 54.4981A-1T(a-3)(c)(2), Temporary Qualified Pension Plan Excise Tax Regs., the Retirement System satisfies the definition of a qualified employer plan because it has been treated by respondent to be such a plan.

The only technical arguments advanced by petitioners concern the qualified status of the Retirement System under section 401(a). Petitioners do not set forth any compelling reason why section 4980A(e)(2) should not be applied to give effect to the plain meaning of the words used therein. Where a statute is clear on its face, as in this case, we require unequivocal evidence of contrary purpose before construing the statute in a manner that overrides the plain meaning of the statutory words. *Huntsberry v. Commissioner*, 83 T.C. 742, 747-748 (1984). No such contrary purpose has been shown here.

Because we are satisfied that our analysis of section 4980A(e)(2) leads to the conclusion that the Retirement System was a qualified employer plan under section

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[6] A possible explanation for this definition of a qualified employer plan is that such a definition prevents an employer maintaining a small employer plan from intentionally disqualifying the plan (by violating one of the technical sec. 401(a) requirements) prior to making a distribution, in order to avoid the excise tax on excess distributions.

4980A, we sustain respondent's determination that petitioner is liable for the 15-percent excise tax under section 4980A.

2. Section 72(t) Issue

Section 72(t) provides for a 10-percent additional tax on early distributions from qualified retirement plans. Paragraph (1), which imposes the tax, provides in relevant part as follows:

> (1) Imposition of additional tax. – If any taxpayer receives any amount from a qualified retirement plan (as defined in section 4974(c)), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

As relevant herein, section 4974(c) defines a qualified employer plan as "a plan described in section 401(a) which includes a trust exempt from tax under section 501(a)" and a plan which the Commissioner at any time has determined to be such a plan.

The 10-percent additional tax does not apply to certain distributions. For example, section 72(t)(2)(A) provides that the 10-percent additional tax does not apply to distributions that are: (1) Made on or after the date on which the taxpayer attains age 59½; (2) made to a beneficiary (or to the estate of the taxpayer) on or after the death of the taxpayer; (3) attributable to the taxpayer's being disabled; or (4) made to a taxpayer after separation from service after attainment of age 55. Petitioners do not

contend that they qualify for any of the statutory exceptions under section 72(t)(2), and indeed they do not satisfy any of those exceptions.

Petitioners advance the same arguments with regard to section 72(t) as they did with respect to section 4980A, namely, that the additional tax under section 72(t) does not apply to petitioner's Transfer Refund because, due to the 1984 plan revisions, the Retirement System was not a qualified retirement plan within the meaning of section 4974(c) at the time that it issued petitioner's Transfer Refund.

Respondent contends that the Retirement System is a qualified retirement plan under the plain language of section 4974(c) because respondent issued a determination letter on June 23, 1982, providing that the Retirement System was such a plan. Respondent further contends that under the plain language of section 4974(c), the qualified status of the Retirement System at the time of petitioner's distribution is irrelevant.

As relevant herein, the definition of a "qualified retirement plan" under section 4974(c) is virtually identical to the definition of a "qualified employer plan" under section 4980A(e)(2). Significantly, the definition of a qualified retirement plan under section 4974(c) specifies, as does the definition of a qualified employer plan under section 4980A(e)(2), that a qualified retirement plan includes a plan that, *at any time*, has been determined by the Commissioner to be such a plan.

Under the plain language of section 4974(c), the Retirement System meets the definition of a qualified retirement plan because, on June 23, 1982, respondent

determined it to be such a plan. Although petitioners contend that the Retirement System must be qualified on the date of petitioner's Transfer Refund in order to be a qualified employer plan, such requirement is inconsistent with the plain meaning of the words used in section 4974(c). Because petitioners offer no compelling reason to construe the words of section 4974(c) in such a way that would be inconsistent with their plain meaning, we give effect to the plain meaning of the words used therein and sustain respondent's determination that petitioners are liable for the 10-percent additional tax under section 72(t).

We have considered petitioners' remaining arguments and find them unpersuasive.

3. Conclusion

In order to give effect to our disposition of the disputed issues, as well as respondent's concession,

Decision will be entered under Rule 155.

Patrick J. CONWAY, et ux., Plaintiffs and Counterclaim Defendants,

v.

UNITED STATES of America, Defendant.

Civ. A. No. MJG-93-1707.

United States District Court,
D. Maryland.

Aug. 10, 1995.

Edward L. Blanton, Jr., Baltimore, MD, for plaintiffs.

Michael J. Salem, Trial Attorney, Tax Div., U.S. Dept. of Justice, Washington, DC, Edward J. Snyder, Chief, Civil Trial Section – Eastern Region, U.S. Department of Justice, Washington, DC, for defendant.

MEMORANDUM AND ORDER

GARBIS, District Judge.

The Court has before it the United States' Motion for Summary Judgment, United States' [Second] Motion for Summary Judgment, Plaintiffs' Motion for Summary Judgment and the materials submitted by the parties relating thereto. The Court has held a hearing and had the benefit of the arguments of counsel.

The Court recognizes that Mr. and Mrs. Conway ("the Taxpayers") acted in good faith and without intent to evade their tax responsibilities. Nevertheless, the Court concludes that, in view of the undisputed facts and the pertinent provisions of the Internal Revenue Code, it must hold for the Government.

The Court notes that the Taxpayers have the right to appeal this Court's decision to the United States Court of Appeals for the Fourth Circuit. They should certainly consider exercising this right if they believe there is any chance to persuade the appellate court to reach a different result. In any event, Mr. and Mrs. Conway (together with all of the other taxpayers similarly situated) should consider seeking a legislative solution in light of their unique, and personally compelling, circumstances.

I. *BACKGROUND*

A. *Facts*

This case involves changes made in the structure of the Maryland State pension systems. In 1927, the State of Maryland created a fund to provide retirement benefits for teachers of the State who were participants in the Maryland Retirement System (the "Old Retirement System"). Maryland created a similar fund in 1941 to provide retirement benefits for all State employees who were participants in the Old Retirement System.[1] The Retirement Systems required mandatory non-deductible contributions from all participants. The Retirement Systems were "qualified defined benefit plans" within the meaning of § 401(a)[2] (1982, 1988), and the trusts maintained as a part of the Retirement Systems were tax exempt under § 501(a) (1982, 1988).

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[1] The two systems, collectively, are referred to as the "Retirement Systems."

[2] All statutory references herein are to the Internal Revenue Code, 26 U.S.C. unless otherwise indicated.

In the late 1970's, actuarial projections indicated that the Retirement Systems were dangerously underfunded. In response to those findings, the State closed eligibility for participation in the Retirement Systems as of January 1, 1980, and developed the Maryland Employees' Pension System and the Maryland Teachers' Pension System (the "Pension Systems") to provide retirement benefits for State employees and teachers hired after that date. The Pension Systems required mandatory nondeductible contributions only from those participants with salaries greater than the taxable wage base set for Social Security benefits. The Pension Systems were "qualified defined benefit plans" within the meaning of § 401(a), and the trusts maintained by the Pension Systems were tax exempt trusts under § 501(a).

After the creation of the Pension Systems and the passage of further pension reform legislation in 1984, members of the Retirement Systems had four options. A member could elect to:

1. Pay an additional two percent of salary and retain unlimited cost of living adjustments on his or her benefits at the time of retirement,

2. Freeze his or her rate of contribution at the then-current level and retain the same benefit formula; however, any future cost of living adjustment would be limited to a maximum of a five percent increase in any one year,

3. Participate in a hybrid plan whereby he or she would receive benefits based on the Retirement System formula to the extent of retirement credit earned up to July 1, 1984,

and benefits based on the Pension System formula for credit earned after that date, or

4. Transfer into the new Pension System. *See Md. State Teachers' Ass'n v. Hughes*, 594 F.Supp. 1353 (D.Md.1984) (providing detailed description of Maryland pension reform).

Plaintiff Patrick J. Conway was a Maryland teacher who chose the fourth option and transferred from the Retirement System to the Maryland Teacher's Pension System in 1990. There is no doubt that Mr. Conway selected this option with the good faith belief that the transfer would not have tax consequences. Upon the transfer, Mr. Conway received a refund of certain contributions paid by him to the Retirement System (the "Transfer Refund").[3] Mr. Conway's service credits, salary level, and other informational data were transferred into his new Pension System account. At the time of distribution, Mr. Conway was less than 59.5 years of age, was not disabled, and had not separated from service as a teacher. Upon receiving his Transfer Refund, Mr. Conway deposited the sum in an Individual Retirement Account ("IRA").

B. ***Procedure***

The Taxpayers filed a joint federal income tax return for 1990. On this return, they disclosed the previously

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[3] Mr. Conway received a total distribution of $80,465.32, representing $21,235.00 of previously taxed contributions, and untaxed earnings of $59,230.32.

untaxed portion of the distribution from the Maryland Retirement System ($59,230.00), but indicated that the taxable amount of this distribution was $0.00. On the Disclosure Statement attached to the return, Mr. Conway stated:

> The amt [sic] that was taxable $59,230 was rolled over to an IRA trusted by First Trust Corp Acct # F12345 and is not included on Line 1040 16A or 16B.

There is no doubt that the Taxpayers took their tax return position in good faith. Nevertheless, the Internal Revenue Service ("IRS") took a different view, and eventually decided to include the previously untaxed portion of the Transfer Refund in the Taxpayers' taxable income. On September 28, 1992, the Taxpayers, in order to meet the jurisdictional prerequisites for their law suit, signed a Form 870[4] permitting the assessment – without notice of deficiency – of deficiencies in income tax, the § 72(t)(1) addition to tax, and the § 4973(a) excise tax on excess contribution to an IRA.

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[4] By signing a Form 870, Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment, the Taxpayers consented to immediate assessment and collection of the deficiencies shown thereon, without waiving their right to pay the tax and file a claim for refund.

On November 24, 1992, the Taxpayers paid the assessments in full,[5] with interest, and timely[6] filed claims for refund. On February 8, 1993, due to a processing error, the IRS refunded the claimed excise tax plus interest.

On June 11, 1993, more than six months after filing their claims for refund of income tax, addition to tax and interest and without IRS action on the claims, the Taxpayers timely[7] filed their law suit. On September 7, 1993, the Government timely[8] filed its Counterclaim seeking a recovery of an erroneous refund of the excise tax plus interest.[9]

In sum, the Court has jurisdiction over the Taxpayers' Complaint and the Government's Counterclaim.

II. *SUMMARY JUDGMENT STANDARD*

Summary judgment is appropriate in those cases in which there is no genuine dispute as to a material fact, and the movant is entitled to judgment as a matter of law. See Rule 56(c), Fed.R.Civ.P.

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[5] The assessment included a minor amount related to adjustments that are not at issue in this case. The I.R.S. formally disallowed the claim on July 9, 1993, after suit was filed.

[6] The claims were filed well within 3 years from the date the return was filed *and* within 2 years of the payments sought to be refunded.

[7] *Id.*

[8] § 6532(b).

[9] *See* West's Federal Forms, National Courts, Ch. 189 (Bergner), § 13497 at 401 (1995).

In this case there is no dispute as to the actions taken by all concerned. The only issues relate to the legal effect of these actions. Accordingly, there is no genuine issue of material fact and a disposition upon a motion for summary judgment is appropriate.

III. *DISCUSSION*

As a general rule, distributions from qualified retirement plans are taxable as ordinary income in the year of distribution. *See* § 402(a) (1988);[10] *Edwards v. Commissioner*, 906 F.2d 114, 115 (4th Cir.1990). A distribution may be entitled to favorable tax treatment, however, if it qualifies as a "partial distribution" and (1) falls within certain "Special Rules"; or (2) qualifies as a "qualified total distribution." *See* § 402(a)(5).

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[10] Section 402 (1988) was amended with respect to distributions made after December 31, 1992. *See* Unemployment Compensation Amendments of 1992, Publ.L. 102-318, 106 Stat. 300, § 521. All references to § 402 in this decision are to the version enacted in 1986 and in effect for distributions made on, or before, January 1, 1993.

According to § 402(a), as enacted in 1986 and in effect in 1990, the year of Plaintiff's distribution:

> The amount actually distributed to any distributee by an employees' trust described in Section 401(a) which is exempt from tax under Section 501(a) shall be taxable to him, in the year in which so distributed, under section 72 (relating to annuities).

At all relevant times, the employees' trust maintained by the Retirement System fell within the description of § 401(a) and was exempt from tax under § 501(a).

A. *There Was a "Partial Distribution"*

A "partial distribution" is defined by the Internal Revenue Code (the "Code") as "any distribution to an employee of *all or any portion* of the balance to the credit of such employee in a qualified trust; except that such term shall not include any distribution which is a qualified total distribution." § 402(E)(v) (emphasis added).

The Taxpayers argue that the distribution could not have been partial because Mr. Conway received the *entire* balance to the credit of his account in the Retirement System qualified trust when he transferred to the Pension System, and what is an *entire* distribution cannot logically be a *partial* distribution. This argument is unavailing because:

1. There was not a distribution of all of Mr. Conway's pension rights, and

2. Even if there was, the Code specifies that a distribution of "all" pension rights is, nonetheless, a "partial" distribution for tax purposes unless it constituted a "qualified total distribution."

According to state law, when a Retirement System member transfers between the Retirement System and the Pension System, any contributions not eligible for refund are transferred into that member's new Pension System account, along with his or her service credits, salary level, and relevant past information accumulated by the Retirement Agency. *See* Md.Code Annot. art. 73B § 32. In this case, although the Taxpayers may have received the full monetary amount credited to Mr. Conway's account with the Retirement System, his service credits, salary levels,

and informational data were transferred to his new Pension System account. Although intangibles such as service credits and salary level may not have a definite or immediately discernible pecuniary worth, they nonetheless represent real value in the calculation of future Pension System benefits. Therefore, the monetary distribution to Mr. Conway did not constitute the "entire" balance to the credit of his account.

Even if there had been a distribution of the entire balance of Mr. Conway's account, it was still a "partial distribution" for tax purposes. The Code specifies that a "partial distribution" includes "*all* or any portion of the balance to the credit of such employee in a qualified trust." (Emphasis added). Therefore, even if the Taxpayers did receive a refund of "all" of the balance to the credit of Mr. Conway's account in the Retirement System, this would still constitute a "partial distribution," unless the refund fell within the statutory definition of a "qualified total distribution."

B. *The "Special Rules" Permitting Rollover Treatment Are Not Applicable*

A "partial distribution" may qualify for "rollover," or tax favorable, treatment if it is transferred to an eligible retirement plan *and* meets certain "Special Rules." Basically, a partial distribution is entitled to rollover treatment *only if*:

1. It was made on account of the employee's death, separation from service, or disability, and is of an amount equal to at least 50

percent of the balance to the credit of the employee in a qualified trust; *and*

2. It was not one of a series of periodic payments, *and*

3. The employee elects to have such treatment apply.

Each of these three requirements must be met.

In this case, the Taxpayers fail to clear the first hurdle. The distribution was not made on account of Mr. Conway's death, separation from service, or disability.[11] Consequently, the distribution at issue did not qualify for rollover treatment and was taxable income in 1990. The Taxpayers are, thus, not entitled to their claimed income tax refund.

C. *There Was No "Qualified Total Distribution"*

1. *Section 402*

The Code defines the term "qualified total distribution" as including "1 or more distributions –

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[11] The Government also has alleged that Taxpayers did not elect to have § 402(a)(5)(A) apply, the third requirement for rollover treatment. *See* United States' [Second] Motion for Summary Judgment at 20 n. 13. Because the distribution did not meet the first requirement, however, it is unnecessary to determine whether Taxpayers failed to make a required election.

> (I) within 1 taxable year of the employee *on account of a termination of the plan* of which the trust is a part . . . (Emphasis added).

§ 402(a)(5)(E)(i)(I) (1988).[12]

The Taxpayers argue that the distribution to Mr. Conway was made *on account of the Retirement System plan's termination* in either 1979 (when the State closed eligibility for participation in the Retirement System for employees hired after January 1, 1980) or 1984 (when the State altered the Retirement System benefit formula). In essence, the Taxpayers argue that while the Plan *trust* may have continued in existence after 1979 and 1984, the Plan itself was not ongoing. Instead, the Taxpayers assert, the Plan was effectively closed and assumed a finite lifespan after January 1, 1980, so that when the last existing member received his or her benefits, the Plan would cease to exist. The Court cannot agree.

The Plan was neither liquidated nor distributed in 1979 or 1984. Nor has it been as of this writing. Significantly, while Taxpayers contend that the Plan terminated in either 1979 or 1984, they did not receive their distributions until 1990, when they voluntarily elected to transfer from the Retirement System to the Pension System. Moreover, the Government notes that in both 1979 and 1984, all existing Plan members, including Mr. Conway, were given the option to remain within the Retirement System.

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[12] The Taxpayers have not contended that the distribution met the "lump sum" requirements of § 402(a)(5)(E)(I)(II), or that it was a "distribution of accumulated deductible employee contributions (within the meaning of § 72(*o*)(5))" under § 402(a)(5)(E)(i)(III).

In sum, although the State closed eligibility for new entry in 1979, the Retirement System remained, and still remains, in existence for those members who elected to stay within the Plan. The fact that it will, at some future time, be terminated cannot make the distribution to Mr. Conway "on account of" the future termination. Indeed, even for the "last of the Mohicans" who gets the Plan's final distribution, the distribution will not be "on account of" the termination. Rather, the termination will be "on account of" the distribution which will render the Plan no longer necessary.

2. *Section 411*

The Taxpayers wish to rely on a definition of "termination" set forth in Treas.Reg. § 1.411(d)-2. According to this regulation, whether a qualified plan has been terminated depends on the facts and circumstances of the case; a reasonable factfinder could determine that a plan terminated, either totally or partially, if: (1) there exists an "exclusion, by reason of a plan amendment . . . of a group of employees who have previously been covered by the plan," or (2) a plan amendment "adversely affects the rights of employees to vest in benefits under the plan." *Id.* The Taxpayers argue that by amending the Plan in 1979 to preclude new hires from entering the Retirement System – hires who previously would have been covered by the plan – "a group of employees who have previously been covered by the plan" was excluded. The Taxpayers also argue that by amending the Plan in 1984 to alter the benefit scheme, the State adversely affected the rights of employees to vest in benefits under the Plan.

The primary problem with the Taxpayers' arguments is that § 411 relates to vesting requirements for ERISA plan qualification, *and is expressly inapplicable to "government plans."* § 411(e)(1)(A). Consequently, the definition of "termination" provided by Treas.Reg. § 1.411(d)-2 does not apply to a government pension plan.[13]

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[13] Even if § 411 provisions were applicable, the Retirement System would not be considered "terminated." No plan members who *"ha[d] previously been covered "* were "excluded" or forced to exit the Retirement Plan in 1979. New employees (employees who arguably *would* have been covered previously, but who were not actually "members previously covered") were simply precluded from becoming members of the Plan. Furthermore, in 1984, all Retirement System Plan members, including Mr. Conway, were given the option to receive benefits under the Plan's former terms as of that date. Only benefits accruing to Plan participants *after* that date would be on modified terms. Therefore, the Plan amendment did not "adversely affect the rights of employees to vest in benefits under the plan."

Finally, a plan provider may alter the terms of a plan if the modification is reasonably necessary and does not substantially impair the participant's benefits. *Baker v. Baltimore County, Md.*, 487 F.Supp. 461 (D.Md.1980); *City of Frederick v. Quinn*, 35 Md.App. 626, 371 A.2d 724 (1977). In *Md. State Teachers Ass'n v. Hughes*, 594 F.Supp. 1353 (D.Md.1984), the Court held that: (1) the 1984 alteration of the Retirement System Plan was reasonably necessary in light of its actuarial unsoundness; and (2) the resulting modifications did not substantially impair the participant's benefits.

In sum, the Retirement System Plan would not have been considered "terminated" even under Treas.Reg. § 1.411(d)-2.

3. *The Section 406 Regulations*

The Regulations under § 406, rather than § 411, are pertinent to the putative "termination" of a government pension plan. Under Treas.Reg. § 1.401-6(b):

> Whether a plan is terminated is generally a question to be determined with regard to all the facts and circumstances in a particular case. For example, a plan is terminated when, in connection with a winding up of the employer's trade or business, the employer begins to discharge his employees. *However, a plan is not terminated . . . merely because an employer consolidates or replaces that plan with a comparable plan.*

(emphasis added). A "comparable plan" for a pension trust would include another pension trust. Treas.Reg. § 1.381(c)(11)-1(d)(4).

Here, the Retirement System Plan was not terminated merely because the State attempted to consolidate or replace the Retirement System pension trust with the "comparable" Pension System pension trust. Nor do there exist other facts and circumstances which would create a genuine issue of material fact on the termination issue. The bottom line is that the Plan was not terminated, and the distribution to the Conways was not made "on account of a termination of the plan." § 402(a)(5)(E)(i)(I). Thus, there was no "qualified total distribution."

D. *The Taxpayers Are Liable For The 10% Additional Tax*

Subject to specified exceptions, when a person receives a distribution from a qualified retirement plan,

that person's income tax liability is "increased by an amount equal to ten percent of the portion of such amount which is includible in gross income." § 72(t)(1) (1988). Mr. Conway's distribution did not fall within any of the listed exceptions.[14] Thus, when Mr. Conway received an early distribution from the Retirement System trust, his income tax liability was properly increased by $5,923.03 (ten percent of $59,230.32, the amount

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[14] Pursuant to § 72(t)(2), the ten percent excise tax does not apply to:

(A) Distributions which are –

(i) made on or after the date on which the employee attains age 59½,

(ii) made to a beneficiary (or to the estate of the employee) on or after the death of the employee,

(iii) attributable to the employee's being disabled,

(iv) part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of such employee and his beneficiary,

(v) made to an employee after separation from service on account of early retirement under the plan after attainment of age 55, or

(vi) dividends paid with respect to stock of a corporation which are described in section 404(k).

(B) Certain distributions made for medical expenses;

(C) Certain distributions made from stock ownership plans; and

(D) Certain distributions made pursuant to a qualified domestic relations order.

received includible in gross income). *See Wheeler v. Commissioner*, 66 T.C.M. 1444, 1446, 1993 WL 488619 The Taxpayers are, consequently, not entitled to a refund of the ten percent addition to tax.

E. *The Taxpayers are Liable For The 6% Excise Tax on Excess Contributions to Individual Retirement Account*

Section 4973(a) imposes a six percent excise tax on excess contributions to an individual retirement account. As pertinent to this case, contributions greater than $2,000 annually are considered "excess." See §§ 219, 4973(b).

As discussed above, the distribution received by Mr. Conway in 1990 was not eligible for tax-free rollover treatment under § 402(a)(5). Consequently, the amount of the distribution transferred to Mr. Conway's IRA in 1990 constitutes a contribution to that IRA. The contribution of $59,230.32 was $57,230.32 in excess of $2,000. This excess is subject to the § 4973(a) six percent excise tax. Thus the Government prevails on its counterclaim seeking recovery of the erroneous refund of this tax plus interest.

IV. *CONCLUSION*

For the foregoing reasons:

1. The United States' Motion for Summary Judgment is GRANTED.
2. The United States' [Second] Motion for Summary Judgment is GRANTED.
3. By September 7, 1995:

a. The Government shall provide an agreed (as to form, but not result) Judgment Order or, absent agreement, provide its proposed Judgment Order.

b. The Taxpayers shall, absent agreement on the form of Judgment Order, provide their own proposed Judgment Order.

SO ORDERED.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

FILED
December 9, 1997

No. 96-2549
93-3499

ALLAN R. POWELL; JOAN K. POWELL

Petitioners – Appellants

v.

COMMISSIONER OF INTERNAL REVENUE

Respondent – Appellee

No. 96-2554
94-8028

RICHARD J. MONTGOMERY;
ADELE S. MONTGOMERY

Petitioners – Appellants

v.

COMMISSIONER OF INTERNAL REVENUE

Respondent – Appellee

On Petition for Rehearing with
Suggestion for Rehearing In Banc

The appellants' petition for rehearing and suggestion for rehearing in banc were submitted to this Court. As no member of this Court or the panel requested a poll on the suggestion for rehearing in banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

IT IS ORDERED that the petition for rehearing and suggestion for rehearing in banc are denied.

For the Court,

/s/ Patricia S. Connor
CLERK

26 U.S.C. § 401. Qualified pension, profit-sharing, and stock bonus plans.

(a) Requirements for qualification. A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section –

(1) if contributions are made to the trust by such employer, or employees, or both, or by another employer who is entitled to deduct his contributions under section 404(a)(3)(B) (relating to deduction for contributions to profit-sharing and stock bonus plans), for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with such plan;

(2) if under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries (but this paragraph shall not be construed, in the case of a multiemployer plan, to prohibit the return of a contribution within 6 months after the plan administrator determines that the contribution was made by a mistake of fact or law (other that a mistake relating to whether the plan is described in section 401(a) or the trust which is part of such plan is exempt from taxation under section 501(a), or the return of any withdrawal liability payment determined to be an overpayment within 6 months of such determination);

(3) if the plan of which such trust is a part satisfies the requirements of section 410 (relating to minimum participation standards); and

(4) if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)). For purposes of this paragraph, there shall be excluded from consideration employees described in section 410(b)(3)(A) and (C).

(5) **Special rules relating to nondiscrimination requirements.** (A) Salaried or clerical employees. A classification shall not be considered discriminatory within the meaning of paragraph (4) or section 410(b)(2)(A)(i) merely because it is limited to salaried or clerical employees.

(B) Contributions and benefits may bear uniform relationship to compensation. A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan bear a uniform relationship to the compensation (within the meaning of section 414(s)) of such employees.

(C) Certain disparity permitted. A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan favor highly compensated employees (as defined in section 414(q)) in the manner permitted under subsection (1).

(D) Integrated defined benefit plan.

(i) In general. A defined benefit plan shall not be considered discriminatory

within the meaning of paragraph (4) merely because the plan provides that the employer-derived accrued retirement benefit for any participant under the plan may not exceed the excess (if any) of –

(I) the participant's final pay with the employer, over

(II) the employer-derived retirement benefit created under Federal law attributable to service by the participant with the employer.

For purposes of this clause, the employer-derived retirement benefit created under Federal law shall be treated as accruing ratably over 35 years.

(ii) Final pay. For purposes of this subparagraph, the participant's final pay is the compensation (as defined in section 414(q)(7)) paid to the participant by the employer for any year –

(I) which ends during the 5-year period ending with the year in which the participant separated from service for the employer, and

(II) for which the participant's total compensation from the employer was highest.

(E) 2 or more plans treated as single plan. For purposes of determining whether 2 or more plans of an employer satisfy the requirements of paragraph (4) when considered as a single plan –

(i) Contributions. If the amount of contributions on behalf of the employees

allowed as a deduction under section 404 for the taxable year with respect to such plans, taken together, bears a uniform relationship to the compensation (within the meaning of section 414(s)) of such employees, the plans shall not be considered discriminatory merely because the rights of employees to, or derived from, the employer contributions under the separate plans do not become nonforfeitable at the same rate.

(ii) Benefits. If the employees' rights to benefits under the separate plans do not become nonforfeitable at the same rate, but the levels of benefits provided by the separate plans satisfy the requirements of regulations prescribed by the Secretary to take account of the differences in such rates, the plans shall not be considered discriminatory merely because of the difference in such rates.

(F) Social security retirement age. For purposes of testing for discrimination under paragraph (4) –

(i) the social security retirement age (as defined in section 415(b)(8)) shall be treated as a uniform retirement age, and

(ii) subsidized early retirement benefits and joint and survivor annuities shall not be treated as being unavailable to employees on the same terms merely because such benefits or annuities are based in whole or in part on an employee's social security retirement age (as so defined).

(6) A plan shall be considered as meeting the requirements of paragraph (3) during the whole of any taxable year of the plan if on one day in each quarter it satisfied such requirements.

(7) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part satisfies the requirements of section 411 (relating to minimum vesting standards).

(8) A trust forming part of a defined benefit plan shall not constitute a qualified trust under this section unless the plan provides that forfeitures must not be applied to increase the benefits any employee would otherwise receive under the plan.

(9) **Required distributions.** (A) In general. A trust shall not constitute a qualified trust under this subsection unless the plan provides that the entire interest of each employee –

(i) will be distributed to such employee not later than the required beginning date, or

(ii) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

(B) Required distribution where employee dies before entire interest is distributed.

(i) Where distributions have begun under subparagraph (A)(ii). A trust shall

not constitute a qualified trust under this section unless the plan provides that if –

(I) the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), and

(II) the employee dies before his entire interest has been distributed to him,

the remaining portion of such interest will be distributed at least as rapidly as under the method of distributions being used under subparagraph (A)(ii) as of the date of his death.

(ii) 5-year rule for other cases. A trust shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), the entire interest of the employee will be distributed within 5 years after the death of such employee.

(iii) Exception to 5-year rule for certain amounts payable over life of beneficiary. If –

(I) any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary,

(II) such portion will be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending

beyond the life expectancy of such beneficiary), and

(III) such distributions begin not later than 1 year after the date of the employee's death or such later date as the Secretary may by regulations prescribe,

for purposes of clause (ii), the portion referred to in subclause (I) shall be treated as distributed on the date on which such distributions begin.

(iv) Special rule for surviving spouse of employee. If the designated beneficiary referred to in clause (iii)(I) is the surviving spouse of the employee –

(I) the date on which the distributions are required to begin under clause (iii)(III) shall not be earlier than the date on which the employee would have attained age 70½, and

(II) if the surviving spouse dies before the distributions to such spouse begin, this subparagraph shall be applied as if the surviving spouse were the employee.

(C) Required beginning date. For purposes of this paragraph –

(i) In general. The term 'required beginning date' means April 1 of the calendar year following the later of –

(I) the calendar year in which the employee attains age 70½, or

(II) the calendar year in which the employee retires.

(ii) Exception. Subclause (II) of clause (i) shall not apply –

(I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 70½, or

(II) for purposes of section 408 (a)(6) or (b)(3).

(iii) Actuarial adjustment. In the case of an employee to whom clause (i)(II) applies who retires in a calendar year after the calendar year in which the employee attains age 70½, the employee's accrued benefit shall be actuarially increased to take into account the period after age 70½ in which the employee was not receiving any benefits under the plan.

(iv) Exception for governmental and church plans. Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term 'church plan' means a plan maintained by a church for church employees, and the term 'church' means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

(D) Life expectancy. For purposes of this paragraph, the life expectancy of an employee and the employee's spouse (other than in the case of a life annuity) may be redetermined but not more frequently than annually.

(E) Designated beneficiary. For purposes of this paragraph, the term "designated beneficiary" means any individual designated as a beneficiary by the employee.

(F) Treatment of payments to children. Under regulations prescribed by the Secretary, for purposes of this paragraph, any amount paid to a child shall be treated as if it had been paid to the surviving spouse if such amount will become payable to the surviving spouse upon such child reaching majority (or other designated event permitted under regulations).

(G) Treatment of incidental death benefit distributions. For purposes of this title, any distribution required under the incidental death benefit requirements of this subsection shall be treated as a distribution required under this paragraph.

(10) **Other requirements.** (A) Plans benefiting owner-employees. In the case of any plan which provides contributions or benefits for employees some or all of whom are owner-employees (as defined in subsection (c)(3)), a trust forming part of such plan shall constitute a qualified trust under this section only if the requirements of subsection (d) are also met.

(B) Top-heavy plans.

(i) In general. In the case of any top-heavy plan, a trust forming part of such plan shall constitute a qualified trust

under this section only if the requirements of section 416 are met.

(ii) Plans which may become top-heavy. Except to the extent provided in regulations, a trust forming part of a plan (whether or not a top-heavy plan) shall constitute a qualified trust under this section only if such plan contains provisions –

(I) which will take effect if such plan becomes a top-heavy plan, and

(II) which meet the requirements of section 416.

(iii) Exemption for governmental plans. This subparagraph shall not apply to any governmental plan.

(11) **Requirement of joint and survivor annuity and preretirement survivor annuity.** (A) In general. In the case of any plan to which this paragraph applies, except as provided in section 417, a trust forming part of such plan shall not constitute a qualified trust under this section unless –

(i) in the case of a vested participant who does not die before the annuity starting date, the accrued benefit payable to such participant is provided in the form of a qualified joint and survivor annuity, and

(ii) in the case of a vested participant who dies before the annuity starting date and who has a surviving spouse, a qualified preretirement survivor annuity is

provided to the surviving spouse of such participant.

(B) Plans to which paragraph applies. This paragraph shall apply to –

(i) any defined benefit plan,

(ii) any defined contribution plan which is subject to the funding standards of section 412, and

(iii) any participant under any other defined contribution plan unless –

(I) such plan provides that the participant's nonforfeitable accrued benefit (reduced by any security interest held by the plan by reason of a loan outstanding to such participant) is payable in full, on the death of the participant, to the participant's surviving spouse (or, if there is no surviving spouse or the surviving spouse consents in the manner required under section 417(a)(2), to a designated beneficiary),

(II) such participant does not elect a payment of benefits in the form of a life annuity, and

(III) with respect to such participant, such plan is not a direct or indirect transferee (in a transfer after December 31, 1984) of a plan which is described in clause (i) or (ii) or to which this clause applied with respect to the participant.

Clause (iii) (III) shall apply only with respect to the transferred assets (and income therefrom)

if the plan separately accounts for such assets and any income therefrom.

(C) Exception for certain ESOP benefits.

(i) in general. In the case of –

(I) a tax credit employee stock ownership plan (as defined in section 409(a)), or

(II) an employee stock ownership plan (as defined in section 4975(e)(7)),

subparagraph (A) shall not apply to that portion of the employee's accrued benefit to which the requirements of section 409(h) apply.

(ii) Nonforfeitable benefit must be paid in full, etc. In the case of any participant, clause (i) shall apply only if the requirements of subclauses (I), (II), and (III) of subparagraph (B)(iii) are met with respect to such participant.

(D) Special rule where participant and spouse married less than 1 year. A plan shall not be treated as failing to meet the requirements of subparagraphs (B)(iii) or (C) merely because the plan provides that benefits will not be payable to the surviving spouse of the participant unless the participant and such spouse had been married throughout the 1-year period ending on the earlier of the participant's annuity starting date or the date of the participant's death.

(E) Exception for plans described in section 404(c). This paragraph shall not apply to a plan which the Secretary has determined is a plan

described in section 404(c) (or a continuation thereof) in which participation is substantially limited to individuals who, before January 1, 1976, ceased employment covered by the plan.

(F) Cross reference. For –

(i) provisions under which participants may elect to waive the requirements of this paragraph, and

(ii) other definitions and special rules for purposes of this paragraph,

see section 417.

(12) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that in the case of any merger or consolidation with, or transfer of assets or liabilities to, any other plan after September 2, 1974, each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated). The preceding sentence does not apply to any multiemployer plan with respect to any transaction to the extent that participants either before or after their transaction are covered under a multiemployer plan to which title IV of the Employee Retirement Income Security Act of 1974 applies.

(13) **Assignment and alienation**. (A) In general. A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated. For purposes of the preceding sentence, there shall not be taken into account any voluntary and

revocable assignment of not to exceed 10 percent of any benefit payment made by any participant who is receiving benefits under the plan unless the assignment or alienation is made for purposes of defraying plan administration costs. For purposes of this paragraph a loan made to a participant or beneficiary shall not be treated as an assignment or alienation if such loan is secured by the participant's accrued nonforfeitable benefit and is exempt from the tax imposed by section 4975 (relating to tax on prohibited transactions) by reason of section 4975(d)(1). This paragraph shall take effect on January 1, 1976 and shall not apply to assignments which were irrevocable on September 2, 1974.

(B) Special rules for domestic relations orders. Subparagraph (A) shall apply to the creation, assignment, or recognition of a right to any benefit payable with respect to a participant pursuant to a domestic relations order, except that subparagraph (A) shall not apply if the order is determined to be a qualified domestic relations order.

(14) A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that, unless the participant otherwise elects, the payment of benefits under the plan to the participant will begin not later than the 60th day after the latest of the close of the plan year in which –

(A) the date or which the participant attains the earlier of age 65 or the normal retirement age specified under the plan,

(B) occurs the 10th anniversary of the year in which the participant commenced participation in the plan, or

(C) the participant terminates his service with the employer.

In the case of a plan which provides for the payment of an early retirement benefit, a trust forming a part of such plan shall not constitute a qualified trust under this section unless a participant who satisfied the service requirements for such early retirement benefit, but separated from the service (with any nonforfeitable right to an accrued benefit) before satisfying the age requirement for such early retirement benefit, is entitled upon satisfaction of such age requirement to receive a benefit not less than the benefit to which he would be entitled at the normal retirement age, actuarially, reduced under regulations prescribed by the Secretary.

(15) a trust shall not constitute a qualified trust under this section unless under the plan of which such trust is a part –

(A) in the case of a participant or beneficiary who is receiving benefits under such plan, or

(B) in the case of a participant who is separated from the service and who has nonforfeitable rights to benefits,

such benefits are not decreased by reason of any increase in the benefit levels payable under title II of the Social Security Act or any increase in the wage base under such title II, if such increase takes place after September 2, 1974, or (if later) the earlier of the date of first receipt of such benefits or the date of such separation, as the case may be.

(16) A trust shall not constitute a qualified trust under this section if the plan of which such trust is a part provides for benefits or contributions which exceed the limitations of section 415.

(17) **Compensation limit**. (A) In general. A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the annual compensation of each employee taken into account under the plan for any year does not exceed $150,000.

(B) Cost-of-living adjustment. The Secretary shall adjust annually the $150,000 amount in subparagraph (A) for increases in the cost-of-living at the same time and in the same manner as adjustments under section 415(d); except that the base period shall be the calendar quarter beginning October 1, 1993, and any increase which is not a multiple of $10,000 shall be rounded to the next lowest multiple of $10,000.

(18) **Repealed**.

(19) A trust shall not constitute a qualified trust under this section if under the plan of which such trust is a part any part of a participant's accrued benefit derived from employer contributions (whether or not otherwise nonforfeitable), is forfeitable solely because of withdrawal by such participant of any amount attributable to the benefit derived from contributions made by such participant. The preceding sentence shall not apply to the accrued benefit to any participant unless, at the time of such withdrawal, such participant has a nonforfeitable right to at least 50 percent of such accrued benefit (as determined under section 411). The first sentence of this paragraph shall not apply to the extent that an

accrued benefit is permitted to be forfeited in accordance with section 411(a)(3)(D)(iii) (relating to proportional forfeitures of benefits accrued before September 2, 1974, in the event of withdrawal of certain mandatory contributions).

(20) A trust forming part of a pension plan shall not be treated as failing to constitute a qualified trust under this section merely because the pension plan of which such trust is a part makes 1 or more distributions within 1 taxable year to a distributee on account of a termination of the plan of which the trust is a part, or in the case of a profit-sharing or stock bonus plan, a complete discontinuance of contributions under such plan. This paragraph shall not apply to a defined benefit plan unless the employer maintaining such plan files a notice with the Pension Benefit Guaranty Corporation (at the time and in the manner prescribed by the Pension Benefit Guaranty Corporation) notifying the Corporation of such payment or distribution and the Corporation has approved such payment or distribution or, within 90 days after the date on which such notice was filed, has failed to disapprove such payment or distribution. For purposes of this paragraph, rules similar to the rules of section 402(a)(6)(B) (as in effect before its repeal by section 521 of the Unemployment Compensation Amendments of 1992) shall apply.

(21) **Repealed.**

(22) If a defined contribution plan (other than a profit-sharing plan) –

> (A) is established by an employer whose stock is not readily tradable on an established market, and

(B) after acquiring securities of the employer, more than 10 percent of the total assets of the plan are securities of the employer,

any trust forming part of such plan shall not constitute a qualified trust under this section unless the plan meets the requirements of subsection (e) of section 409. The requirements of subsection (e) of section 409 shall not apply to any employees of an employer who are participants in any defined contribution plan established and maintained by such employer if the stock of such employer is not readily tradable on an established market and the trade or business of such employer consists of publishing on a regular basis a newspaper for general circulation. For purposes of the preceding sentence, subsections (b), (c), (m), and (o) of section 414 shall not apply except for determining whether stock of the employer is not readily tradable on an established market.

(23) A stock bonus plan shall not be treated as meeting the requirements of this section unless such plan meets the requirements of subsections (h) and (o) of section 409, except that in applying section 409(h) for purposes of this paragraph, the term "employer securities" shall include any securities of the employer held by the plan.

(24) Any group trust which otherwise meets the requirements of this section shall not be treated as not meeting such requirements on account of the participation or inclusion in such trust of the moneys of any plan or governmental unit described in section 818(a)(6).

(25) **Requirement that actuarial assumptions be specified.** A defined benefit plan shall not be treated as providing definitely determinable benefits unless,

whenever the amount of any benefit is to be determined on the basis of actuarial assumptions, such assumptions are specified in the plan in a way which precludes employer discretion.

(26) **Additional participation requirements.** (A) In general. In the case of a trust which is a part of a defined benefit plan, such trust shall not constitute a qualified trust under this subsection unless on each day of the plan year such trust benefits at least the lesser of –

(i) 50 employees of the employer, or

(ii) the greater of –

(I) 40 percent of all employees of the employer, or

(II) 2 employees (or if there is only 1 employee, such employee).

(B) Treatment of excludable employees.

(i) In general. A plan may exclude from consideration under this paragraph employees described in paragraphs (3) and (4)(A) of section 410(b).

(ii) Separate application for certain excludable employees. If employees described in section 410(b)(4)(B) are covered under a plan which meets the requirements of subparagraph (A) separately with respect to such employees, such employees may be excluded from consideration in determining whether any plan of the employer meets such requirements if–

(I) the benefits for such employees are provided under the same plan as benefits for other employees,

(II) the benefits provided to such employees are not greater than comparable benefits provided to other employees under the plan, and

(III) no highly compensated employee (within the meaning of section 414(q)) is included in the group of such employees for more than 1 year.

(C) Eligibility to participate. In the case of contributions under section 401(k) or 401(m), employees who are eligible to contribute (or may elect to have contributions made on their behalf) shall be treated as benefiting under the plan.

(D) Special rule for collective bargaining units. Except to the extent provided in regulations, a plan covering only employees described in section 410(b)(3)(A) may exclude from consideration any employees who are not included in the unit or units in which the covered employees are included.

(E) Paragraph not to apply to multiemployer plans. Except to the extent provided in regulations, this paragraph shall not apply to employees in a multiemployer plan (within the meaning of section 414(f)) who are covered by collective bargaining agreements.

(F) Special rule for certain dispositions or acquisitions. Rules similar to the rules of section 410(b)(6)(C) shall apply for purposes of this paragraph.

(G) Separate lines of business. At the election of the employer and with the consent of the Secretary, this paragraph may be applied separately with respect to each separate line of business of the employer. For purposes of this paragraph, the term "separate line of business" has the meaning given such term by section 414(r) (without regard to paragraph (2)(A) or (7) thereof).

(H) Special rule for certain police or firefighters.

(i) In general. An employer may elect to have this paragraph applied separately with respect to any classification of qualified public safety employees for whom a separate plan is maintained.

(ii) Qualified public safety employee. For purposes of this subparagraph, the term "qualified public safety employee" means any employee of any police department or fire department organized and operated by a State or political subdivision if the employee provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such State or political subdivision.

(I) Regulations. The Secretary may by regulation provide that any separate benefit structure, any separate trust, or any other separate arrangement is to be treated as a separate plan for purposes of applying this paragraph.

(27) **Determinations as to profit-sharing plans.** (A) Contributions need not be based on profits. The determination of whether the plan under which any contributions are made is a profit-sharing plan shall be made without regard to current or accumulated profits of the employer and without regard to whether the employer is a tax-exempt organization.

(B) Plan must designate type. In the case of a plan which is intended to be a money purchase pension plan or a profit-sharing plan, a trust forming part of such plan shall not constitute a qualified trust under this subsection unless the plan designates such intent at such time and in such manner as the Secretary may prescribe.

(28) **Additional requirements relating to employee stock ownership plans.** (A) In general. In the case of a trust which is part of an employee stock ownership plan (within the meaning of section 4975(e)(7)) or a plan which meets the requirements of section 409(a), such trust shall not constitute a qualified trust under this section unless such plan meets the requirements of subparagraphs (B) and (C).

(B) Diversification of investments.

(i) In general. A plan meets the requirements of this subparagraph if each qualified participant in the plan may elect within 90 days after the close of each plan year in the qualified election period to direct the plan as to the investment of at least 25 percent of the participant's account in the plan (to the extent such portion exceeds the amount to which a prior election under this subparagraph applies). In the case of the election year in

which the participant can make his last election, the preceding sentence shall be applied by substituting "50 percent" for "25 percent".

(ii) Method of meeting requirements. A plan shall be treated as meeting the requirements of clause (i) if –

(I) the portion of the participant's account covered by the election under clause (i) is distributed within 90 days after the period during which the election may be made, or

(II) the plan offers at least 3 investment options (not inconsistent with regulations prescribed by the Secretary) to each participant making an election under clause (i) and within 90 days after the period during which the election may be made, the plan invests the portion of the participant's account covered by the election in accordance with such election.

(iii) Qualified participant. For purposes of this subparagraph, the term "qualified participant" means any employee who had completed at least 10 years of participation under the plan and has attained age 55.

(iv) Qualified election period. For purposes of this subparagraph, the term "qualified election period" means the 6-plan-year period beginning with the later of –

(I) the 1st plan year in which the individual first became a qualified participant, or

(II) the 1st plan year beginning after December 31, 1986.

For purposes of the preceding sentence, an employer may elect to treat an individual first becoming a qualified participant in the 1st plan year beginning in 1987 as having become a participant in the 1st plan year beginning in 1988.

(C) Use of independent appraiser. A plan meets the requirements of this subparagraph if all valuations of employer securities which are not readily tradable on an established securities market with respect to activities carried on by the plan are by an independent appraiser. For purposes of the preceding sentence, the term "independent appraiser" means any appraiser meeting requirements similar to the requirements of the regulations prescribed under section 170(a)(1).

(29) **Security required upon adoption of plan amendment resulting in significant underfunding.** (A) In general. If –

(i) a defined benefit plan (other than a multiemployer plan) to which the requirements of section 412 apply adopts an amendment an effect of which is to

increase current liability under the plan for a plan year, and

(ii) the funded current liability percentage of the plan for the plan year in which the amendment takes effect is less than 60 percent, including the amount of the unfunded current liability under the plan attributable to the plan amendment,

the trust of which such plan is a part shall not constitute a qualified trust under this subsection unless such amendment does not take effect until the contributing sponsor (or any member of the controlled group of the contributing sponsor) provides security to the plan.

(B) Form of security. The security required under subparagraph (A) shall consist of –

(i) a bond issued by a corporate surety company that is an acceptable surety for purposes of section 412 of the Employee Retirement Income Security Act of 1974,

(ii) cash, or United States obligations which mature in 3 years or less, held in escrow by a bank or similar financial institution, or

(iii) such other form of security as is satisfactory to the Secretary and the parties involved.

(C) Amount of security. The security shall be in an amount equal to the excess of –

(i) the lesser of –

(I) the amount of additional plan assets which would be necessary to increase the funded current liability

percentage under the plan to 60 percent, including the amount of the unfunded current liability under the plan attributable to the plan amendment, or

(II) the amount of the increase in current liability under the plan attributable to the plan amendment and any other plan amendments adopted after December 22, 1987, and before such plan amendment, over

(ii) $10,000,000.

(D) Release of security. The security shall be released (and any amounts thereunder shall be refunded together with any interest accrued thereon) at the end of the first plan year which ends after the provision of the security and for which the funded current liability percentage under the plan is not less than 60 percent. The Secretary may prescribe regulations for partial releases of the security by reason of increases in the funded current liability percentage.

(E) Definitions. For purposes of this paragraph, the terms "current liability", "funded current liability percentage", and "unfunded current liability" shall have the meanings given such terms by section 412(1), except that in computing unfunded current liability there shall not be taken into account any unamortized portion of the unfunded old liability amount as of the close of the plan year.

(30) **Limitations on elective deferrals**. In the case of a trust which is part of a plan under which elective deferrals (within the meaning of section

402(g)(3)) may be made with respect to any individual during a calendar year, such trust shall not constitute a qualified trust under this subsection unless the plan provides that the amount of such deferrals under such plan and all other plans, contracts, or arrangements of an employer maintaining such plan may not exceed the amount of the limitation in effect under section 402(g)(1) for taxable years beginning in such calendar year.

(31) **Optional direct transfer of eligible rollover distributions.** (A) In general. A trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution –

(i) elects to have such distribution paid directly to an eligible retirement plan, and

(ii) specifies the eligible requirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe),

such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

(B) Limitation. Subparagraph (A) shall apply only to the extent that the eligible rollover distribution would be includable in gross income if not transferred as provided in subparagraph (A) (determined without regard to sections 402(c) and 403(a)(4)).

(C) Eligible rollover distribution. For purposes of this paragraph, the term "eligible rollover distribution" has the meaning given such term by section 402(f)(2)(A).

(D) Eligible retirement plan. For purposes of this paragraph, the term "eligible retirement plan" has the meaning given such term by section 402(c)(8)(B), except that a qualified trust shall be considered an eligible retirement plan only if it is a defined contribution plan, the terms of which permit the acceptance of rollover distributions.

(32) **Treatment of failure to make certain payments if plan has liquidity shortfall.** (A) In general. A trust forming part of a pension plan to which section 412(m)(5) applies shall not be treated as failing to constitute a qualified trust under this section merely because such plan ceases to make any payment described in subparagraph (B) during any period that such plan has a liquidity shortfall (as defined in section 412(m)(5)).

(B) Payments described. A payment is described in this subparagraph if such payment is –

(i) any payment, in excess of the monthly amount paid under a single life annuity (plus any social security supplements described in the last sentence of section 411(a)(9)), to a participant or beneficiary whose annuity starting date (as defined in section 417(f)(2)) occurs during the period referred to in subparagraph (A),

(ii) any payment for the purchase of an irrevocable commitment from an insurer to pay benefits, and

(iii) any other payment specified by the Secretary by regulation.

(C) Period of shortfall. For purposes of this paragraph, a plan has a liquidity shortfall during the period that there is an underpayment of an installment under section 412(m) by reason of paragraph (5)(A) thereof.

(33) **Prohibition on benefit increases while sponsor is in bankruptcy.** (A) In general. A trust which is part of a plan to which this paragraph applies shall not constitute a qualified trust under this section if an amendment to such plan is adopted while the employer is a debtor in a case under title 11, United States Code, or similar Federal or State law, if such amendment increases liabilities of the plan by reason of –

(i) any increase in benefits,

(ii) any change in the accrual of benefits, or

(iii) any change in the rate at which benefits become nonforfeitable under the plan,

with respect to employees of the debtor, and such amendment is effective prior to the effective date of such employer's plan of reorganization.

(B) Exceptions. This paragraph shall not apply to any plan amendment if –

(i) the plan, were such amendment to take effect, would have a funded current liability percentage (as defined in section 412(1)(8)) of 100 percent or more,

(ii) the Secretary determines that such amendment is reasonable and provides

for only de minimis increases in the liabilities of the plan with respect to employees of the debtor,

(iii) such amendment only repeals an amendment described in subsection 412(c)(8)), or

(iv) such amendment is required as a condition of qualification under this part.

(C) Plans to which this paragraph applies. This paragraph shall apply only to plans (other than multiemployer plans) covered under section 4021 of the Employee Retirement Income Security Act of 1974.

(D) Employer. For purposes of this paragraph, the term "employer" means the employer referred to in section 412(c)(11) (without regard to subparagraph (B) thereof).

(34) **Benefits of missing participants on plan termination.** In the case of a plan covered by title IV of the Employee Retirement Income Security Act of 1974, a trust forming part of such plan shall not be treated as failing to constitute a qualified trust under this section merely because the pension plan of which such trust is a part, upon its termination, transfers benefits of missing participants to the Pension Benefit Guaranty Corporation in accordance with section 4050 of such Act.

Paragraphs (11), (12), (13), (14), (15), (19), and (20) shall apply only in the case of a plan to which section 411 (relating to minimum vesting standards) applies without regard to subsection (e)(2) of such section.

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26 U.S.C. § 402(a)(5)

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(E) Definitions. For purposes of this paragraph –

(i) Qualified total distribution. The term "qualified total distribution" means 1 or more distributions –

(I) within 1 taxable year of the employee on account of a termination of the plan of which the trust is a part or, in the case of a profit-sharing or stock bonus plan, a complete discontinuance of contributions under such plan,

(II) which constitute a lump sum distribution within the meaning of subsection (e)(4)(A) (determined without reference to subparagraphs (B) and (H) of subsection (e)(4)), or

(III) which constitute a distribution of accumulated deductible employee contributions (within the meaning of section 72(o)(5)).

* * *

26 U.S.C. § 402(e)

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(4) Definitions and special rules.

(A) Lump sum distribution. For purposes of this section and section 403, the term "lump sum distribution" means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient –

(i) on account of the employee's death,

(ii) after the employee attains age 59½,

(iii) on account of the employee's separation from the service, or

(iv) after the employee has become disabled (within the meaning of section 72(m)(7))

from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a). Clause (iii) of this subparagraph shall be applied only with respect to an individual who is an employee without regard to section 401(c)(1), and clause (iv) shall be applied only with respect to an employee within the meaning of section 401(c)(1). A distribution of an annuity contract from a trust or annuity plan referred to in the first sentence of this subparagraph shall be treated as a lump sum distribution. For purpose of this subparagraph, a distribution to two or more trusts shall be treated as a distribution to one recipient. For purposes of this subsection, the balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of section 72(o)(5)).

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26 U.S.C. § 72

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(t) 10-Percent Additional Tax on Early Distributions From Qualified Retirement Plans. –

(1) Imposition of additional tax. – If any taxpayer receives any amount from a qualified retirement plan (as defined in section 4974(c)), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

* * *

26 U.S.C. SEC. 4980A. TAX ON EXCESS DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.

(a) General Rule. – There is hereby imposed a tax equal to 15 percent of the excess distributions with respect to any individual during any calendar year.

(b) Liability for Tax. – The individual with respect to whom the excess distributions are made shall be liable for the tax imposed by subsection (a). The amount of the tax imposed by subsection (a) shall be reduced by the amount (if any) of the tax imposed by section 72(t) to the extent attributable to such excess distributions.

(c) Excess Distributions. – For purposes of this section –

> **(1) In general.** – The term "excess distributions" means the aggregate amount of the retirement distributions with respect to any individual during any calendar year to the extent such amount exceeds the greater of –
>
> (A) $150,000 or
>
> (B) $112,500 (adjusted at the same time and in the same manner as under section 415(d)).
>
> **(2) Exclusion of certain distributions.** – The following distributions shall not be taken into account under paragraph (1):
>
> (A) Any retirement distribution with respect to an individual made after the death of such individual.
>
> (B) Any retirement distribution with respect to an individual payable to an alternate payee pursuant to a qualified domestic

relations order (with the meaning of section 414(p)) if includible in income of the alternate payee.

(C) Any retirement distributions with respect to an individual which is attributable to the individual's investment in the contract (as defined in section 72(f)).

(D) Any retirement distribution to the extent not included in gross income by reason of a rollover contribution.

(E) Any retirement distribution with respect to an individual of an annuity contract the value of which is not includible in gross income at the time of the distribution (other than distributions under, or proceeds from the sale or exchange of, such contract).

(F) Any retirement distribution with respect to an individual of –

(i) excess deferrals (and income allocable thereto) under section 402(g)(2)(A)(ii), or

(ii) excess contributions (and income allocable thereto) under section 401(k)(8) or 408(d)(4) or excess aggregate contributions (and income allocable thereto) under section 401(m)(6).

Any distribution described in subparagraph (B) shall be treated as a retirement distribution to the person to whom paid for purposes of this section.

* * *

(e) Retirement Distributions. – For purposes of this section –

(1) In general. – The term "retirement distribution" means with respect to any individual, the amount distributed during the taxable year under –

(A) any qualified employer plan with respect to which such individual is or was the employee, and

(B) any individual retirement plan.

(2) Qualified employer plan. – The term "qualified employer plan" means –

(A) any plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(B) an annuity plan described in section 403(a), or

(C) an annuity contract described in section 403(b).

Such term includes any plan or contract which, at any time, has been determined by the Secretary to be such a plan or contract.

26 U.S.C. SEC. 4974. EXCISE TAX ON CERTAIN ACCUMULATIONS IN QUALIFIED RETIREMENT PLANS.

(c) Qualified Retirement Plan. – For purposes of this section, the term "qualified retirement plan" means –

(1) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(2) an annuity plan described in section 403(a),

(3) an annuity contract described in section 403(b),

(4) an individual retirement account described in section 408(a), or

(5) an individual retirement annuity described in section 408(b).

Such term includes any plan, contract, account, or annuity which, at any time, has been determined by the Secretary to be such a plan, contract, account, or annuity.